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No. 89-____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

GULF STATES UTILITIES COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

Petitioner Gulf States Utilities Company entered into a contract with an unaffiliated utility for the long-term purchase of large amounts of electric capacity and associated electric energy. The questions presented are these:

1. Under Section 206 of the Federal Power Act, 16 U.S.C. § 824(e), is it irrelevant as a matter of law to the determination whether the contract continues to be just, reasonable, and in the public interest, that (a) unexpected changes in market conditions beyond the control of either party are resulting in an unintended, inefficient and unfair distribution of benefits and burdens on the systems of the seller and the buyer; and (b) Gulf States, a major public utility, would be rendered insolvent if it were required to purchase pursuant to the contract?

2. Did the Federal Energy Regulatory Commission adequately explain its decision that, in determining whether the contract continues to be just, reasonable, and in the public interest, it is irrelevant as a matter of law that the contract is resulting in an unintended, inefficient and unfair distribution of benefits and burdens on the systems of the seller and the buyer?

LIST OF PARTIES AND RULE 29.1 LIST

The parties in the court of appeals were:

1. Gulf States Utilities Company, Petitioner
2. Federal Energy Regulatory Commission, Respondent
3. Sam Rayburn G&T Electric Corporation, Inc., Intervenor
4. Louisiana Public Service Commission, Intervenor
5. Southern Company Services, Inc., Intervenor
6. Georgia Power Company, Intervenor
7. Gulf Power Company, Intervenor
8. Mississippi Power Company, Intervenor
9. Alabama Power Company, Intervenor

Gulf States Utilities Company is a corporation chartered under the laws of Texas, and has no publicly owned parent, subsidiary or affiliate.

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FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner Gulf States Utilities Company ("Gulf States") requests that a writ of certiorari issue to review the judgment, filed September 22, 1989, of the United States Court of Appeals for the District of Columbia Circuit.

OPINIONS BELOW

The judgment of the Court of Appeals is not reported and is reprinted in the appendix hereto ("App.") at 1a. The Court of Appeals' orders denying Gulf States' petition for rehearing and suggestion of rehearing *en banc* are not reported and are reprinted at App. 2a and 3a, respectively.

The Federal Energy Regulatory Commission's ("FERC" or "Commission") April 1, 1988 Opinion and Order Affirming Initial Decision in Part, Dismissing Complaint, and Terminat-

ing Dockets in *Southern Company Services, Inc.*, FERC Docket No. EL86-53-001, and *Gulf States Utilities Co.* v. *Southern Company Services, Inc.*, FERC Docket No. EL86-57-001, from which Gulf States petitioned for review, is reported at 43 FERC (CCH) ¶61,003 (1988) and is reprinted here beginning at App. 4a. The Commission's June 1, 1988 Order Denying Rehearing and Terminating Dockets in those dockets, from which Gulf States also petitioned for review, is reported at 43 FERC (CCH) ¶61,394 (1988) and is reprinted here beginning at App. 33a. The administrative law judge's Initial Decision on Petition for Declaratory Order and Complaint in those dockets is reported at 39 FERC (CCH) ¶63,026 (1987) and is reprinted here beginning at App. 37a.

JURISDICTION

The judgment of the Court of Appeals was filed on September 22, 1989, App. 1a, and a timely petition for rehearing and suggestion of rehearing *en banc* were denied by orders filed November 27, 1989, App. 2a, 3a. This petition is being filed within 90 days of those orders. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

PERTINENT STATUTORY PROVISION

Section 206(a) of the Federal Power Act, 16 U.S.C. § 824e(a), provides:

> (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. Any complaint or motion of the Commission to initiate a proceeding under this section shall state the

change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.

STATEMENT OF THE CASE

A. Introduction

This case involves an important issue relating to the FERC's responsibilities under Section 206 of the Federal Power Act, 16 U.S.C. § 824e, the primary federal statute regulating the rates of wholesale power transactions. In rejecting a claim by a buyer that a capacity contract no longer is just, reasonable and in the public interest, the FERC ruled that it is not even "germane" that market changes are causing an unintended, inefficient and unfair mismatch of burdens and benefits under the contract. Under this holding, the FERC need not even consider such a mismatch as part of an overall assessment of the interests of rate payers on the buying and selling systems in particular cases. The FERC's narrow interpretation, which entails an unsupportable legal distinction between buyers and sellers, finds no basis in either statutory language or judicial precedent. Under cases previously decided by this Court, the FERC would be required to take into account similar considerations when advanced by a seller.

In reaching its conclusion, the FERC relied solely upon two unreviewed cases in which it had rejected prudency challenges to a contract at the time of its initial approval (and not, as here, after supervening market changes had radically altered the benefits and burdens). Yet elsewhere in its opinion the FERC expressly stated (correctly) that prudency is not at issue in this case.

Although its interpretation was not compelled by statutory language, the FERC never explained how its view of relevance advances, or is even consonant with, statutory objectives.

Those objectives include both attracting sufficient capital to the electric utility industry and efficient incentives in the choice between building or buying capacity. These objectives can only be impaired by the FERC's decision. Utilities buying firm capacity are not allowed to mark it up when they resell it; at most, they may pass through their cost. (Sellers, by contrast, are allowed a profit.) Thus, when buyers make a purchase decision that turns out to be economic, they cannot profit. When they make a decision that turns out to be uneconomic, they face the risk of disallowance (as happened in this case). Exacerbating this one-way ratchet, the FERC declines even to consider relevant a mismatch of benefits and burdens on the buying and selling systems.

This is a matter of substantial importance in this essential industry. *See infra* at 15-20. The legal issue requires resolution by this Court.

B. Nature of the Case

Gulf States is a public utility serving the Texas and Louisiana Gulf Coast. It sells electricity in Texas and Louisiana at wholesale and retail to industrial, commercial and residential customers, and to municipal utilities. It generates such electricity from its own (primarily gas-fired) generation plants or purchases such electricity from off-system wholesalers.

This case involves Gulf States' request that the Commission modify a wholesale electric power contract[1] that has become grossly injurious to the consuming public and that threatens Gulf States' solvency. Specifically, Gulf States sought relief from an obligation to purchase electric power generation capacity and energy that, due to dramatically changed economic circumstances and unexpected adverse state regulatory decisions, it no longer needed or could afford. Gulf States

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[1] Although the transaction at issue in this case involved both a Unit Power Sales Agreement and an Interchange Contract (*see infra* at 6), for purposes of simplicity, they will be referred to hereinafter collectively as the "contract."

invoked the Commission's authority under Section 206 to review and, if necessary, modify wholesale electric power contracts to ensure that they are just, reasonable, nondiscriminatory and otherwise in the public interest. Section 206 gives the FERC "plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968).

Gulf States argued, among other things, that because of falling demand within its service region, the capacity under the contract plus its own capacity left it with reserve margins substantially exceeding planned levels. Since both its own and the contractual capacity had to be paid for whether or not used, the result was a crushing burden of fixed costs. Gulf States also argued that because gas prices had fallen relative to the costs of coal, it could generate energy more cheaply than could the seller. In rejecting these arguments, the Commission made a legal determination, without adequate explanation, that "lack of benefits or mismatch between benefits and burdens" on the systems of the seller and the buyer is "not germane to an assessment of the contracts' justness and reasonableness." App. 4a at 15a, 43 FERC (CCH) at 61,015. The Commission thus abdicated its responsibility to protect the public interest through the supervision of wholesale contracts between regulated entities.

The FERC also refused to recognize the impact of the contract on Gulf States' financial position and on Gulf States' customers. Although Gulf States established that relief from the contract at issue is essential to its financial viability, the Commission refused to consider the consequences to the consuming public of the insolvency of a major supplier of an essential service such as electricity.[2]

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[2] In so doing, the Commission acted contrary to its own prior decision in *Potomac Electric Power Co.*, 56 F.P.C. 2410, 2412 (1975) (Initial Decision), *adopted*, 56 F.P.C. 2398 (1976), which stated that "a

C. History and Purpose of the Contract

In the early 1970s, the Southern Companies ("Southern"),[3] a major electric utility holding company, initiated an ambitious construction program among its affiliates designed to add approximately 37,000 megawatts ("MW") of new, primarily coal-fired electric generation capacity. Southern began a concerted effort to sell the excess capacity and energy to be produced by this program to neighboring utilities.

In early 1981, during a period of rising natural gas prices and steady economic growth in its service area, Gulf States found itself facing a potential power supply deficit and an overdependence on natural gas. As a part of its efforts to address these concerns, Gulf States entered into discussions with Southern in August 1981 about the possibility of obtaining power from the Southern system. On February 25, 1982, Southern and Gulf States entered into a Unit Power Sales Agreement ("UPS Agreement")[4] and an Interchange Contract.[5] The UPS Agree-

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public utility is not just another private business which should be left free to boom or go bust as its management and the fates dictate. It is a business 'affected with a public interest.' It provides a vital service and has a monopoly on doing so."

[3] Southern is a public utility holding company which, through its affiliates (Alabama Power, Georgia Power, Gulf Power, Mississippi Power and Southern Company Services), sells electricity at wholesale and retail in parts of Alabama, Georgia, Florida and Mississippi.

[4] A "UPS Agreement" involves a purchase and sale of the right to take and use a specified portion of the generating capacity (measured in megawatts) of a designated electric generating unit for a specified time. It may also, as here, obligate the purchaser to take or pay for minimum amounts of energy produced by the unit.

[5] The Interchange Agreement provided, *inter alia*, for establishment of an interconnection point between the Southern and Gulf States systems, which had not been directly connected, and set forth, in the form of Service Schedules, the terms and conditions of various services to be provided by Gulf States to Southern and vice versa.

ment provided that Gulf States would purchase 500 MW of capacity from designated Southern units during the last six months of 1984, during each year from 1985 through 1991 and then through May 31, 1992.[6] Gulf States also agreed to purchase certain minimum amounts of energy associated with that capacity.

The parties assumed that they would mutually benefit by allocating to Gulf States capacity that Southern asserted to be surplus to it during a projected short-term shortage on Gulf States' system. The UPS Agreement expressly recognized that demand in the electric utility business was uncertain and that the contract terms and conditions might have to be adjusted to take account of future developments: Section 2.2 recognized "that [the] long-range plans and forecasts which provide the basis for such sales and purchases of capacity are affected by many factors" and Section 2.2.1 provided that if Gulf States or Southern desired to increase *or decrease* the amount of capacity being purchased and sold, the parties would negotiate in good faith "to evaluate alternatives which may reasonably provide for such desired change in capacity." The contract also provided that, if the parties could not reach a negotiated agreement on changes, the contract was subject to change by FERC order: Section 1.1 of the UPS Agreement provided that after acceptance of the contracts by the FERC, "such rates, terms and conditions as are approved in the applicable final order shall control for purposes of this Agreement subject to change by mutual agreement or by subsequent final orders of FERC."

Major economic changes subsequently caused Gulf States to lower its load and gas price forecasts substantially, and to conclude that it would not need any of the Southern capacity until 1991 at the earliest. Moreover, despite the fact that its

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[6] On May 12, 1982, Gulf States and Southern entered into Amendment No. 1 to the UPS Agreement which, *inter alia*, increased by 500 MW, to 1,000 MW, the amount of power that Gulf States was to purchase from June 1, 1985 through May 31, 1992.

purpose in purchasing the second 500 MW of unit power (*see supra* n.6) had been to obtain low cost displacement energy,[7] Gulf States' revised fuel price projections showed that the contract price for the Southern capacity and energy over the life of the contract would exceed Gulf States' cost of generating that power itself. Accordingly, in September 1983, Gulf States requested negotiations under the UPS Agreement to consider reducing or eliminating its capacity purchase obligations. These talks (in which the Louisiana Public Service Commission ("LPSC") participated) culminated in a December 6, 1983 Settlement Agreement, which modified the terms of the contract in various respects, but preserved Gulf States' obligation to purchase 1,000 MW of capacity and certain associated energy.

The first sales from Southern to Gulf States were made in January 1984 in accordance with the terms of an interim agreement pending FERC approval of the Settlement Agreement. On March 23, 1984 the FERC approved the agreements, as amended, finding them to be just, reasonable and in the public interest under Section 206. *Southern Co. Servs., Inc.*, 26 FERC (CCH) ¶61,360 (1984). Sales under the contract, as amended, began in May 1984 and unit power sales began in January 1985.

The economic depression in Gulf States' service area worsened after the execution of the Settlement Agreement, resulting in a severe reduction in the rate of residential and commercial load growth and large losses of industrial load. As a result, Gulf States experienced reserve margins[8] approximating 33-45%, substantially exceeding both planned levels and levels generally considered in the industry to be adequate and

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[7] "Displacement energy" is energy purchased to displace higher cost energy available on the purchaser's system.

[8] "Reserve margin" is a measure of the extent to which an electric utility's generating capacity (owned and purchased) exceeds its projected peak requirements.

desirable.[9] In addition, natural gas became available at prices that made gas-fired energy generated by Gulf States substantially cheaper than Southern's coal-fired energy; this situation was expected to continue through the remainder of the contract period. Because of its load losses since 1983 and the continuing decline in natural gas prices, Gulf States informed Southern on August 26, 1985 that it was compelled to seek renegotiation of the 1983 contract. Gulf States also apprised Southern that its financial situation had worsened[10] and suggested several alternatives for modifying the contract. These discussions did not lead to further modifications to the contract.

Gulf States had entered into the original UPS Agreement and Interchange Contract in February 1982, into Amendment No. 1 in May 1982 and into the Settlement Agreement in December 1983, with the expectation that the Texas and Louisiana regulatory authorities would allow it to recover payments to Southern for capacity and energy.[11] Subsequently, however

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[9] Historically, reserve margins of approximately 20% have been considered adequate. *See* Notice of Proposed Rulemaking, "Regulations Governing Independent Power Producers," 53 Fed. Reg. 9,327 (1988), IV *FERC Stats. and Regs.* (CCH) ¶ 32,456, 32,136 n.30 (1988) ("IPP NOPR"); U.S. Congress, Office of Technology Assessment, *Electric Power Wheeling and Dealing: Technological Considerations for Increasing Competition* 162, OTA-E-409 (May 1989).

[10] It is undisputed that, from December 1985 through November 1986, Gulf States had no cash earnings, and it projected a $410 million cash shortfall in 1987, which was expected to grow in 1988 and 1989, even before any capacity payments to Southern.

[11] The LPSC intervened when the contracts were filed with the FERC, and consented to the 1983 Settlement Agreement. Although the Public Utilities Commission of Texas ("PUCT") was not an intervenor in that proceeding, it issued later orders evidencing its approval of the contracts. Both commissions permitted Gulf States to pass through and recover associated costs during the early stages of the contracts. *See Southern Co. Servs., Inc.*, App. 37a at 104a-105a, 39 FERC (CCH) ¶ 63,026 at 65,162 (1987) (Initial Decision).

in 1986, both state commissions issued orders prohibiting Gulf States from recovering any capacity charges on the contracts from its retail customers.[12] These decisions, if upheld, will prevent Gulf States from recovering contract obligations amounting to more than $880 million over the balance of the term of the contract. Gulf States' appeals of both orders are pending.

D. Course of Proceedings and Disposition Below

On August 25, 1986, Southern Company Services, acting on behalf of itself and the other Southern Companies members, filed a petition with the FERC requesting that the Commission, *inter alia*, (1) declare that it had exclusive or primary jurisdiction over the UPS Agreement and the Interchange Contract;[13] (2) make certain declarations concerning sections

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[12] The PUCT order, signed October 15, 1986, prohibited Gulf States from recovering any capacity charges from Texas ratepayers and was based on the PUCT's belief that Gulf States had been "imprudent" in entering into the contracts. The LPSC order, issued November 12, 1986, directed Gulf States to cease collecting capacity charges from Louisiana retail ratepayers and was based on the LPSC's belief that the power was not "used and useful" because, even without it, Gulf States' reserves were substantially in excess of the amount required for reliable service.

[13] Shortly before Southern initiated the FERC proceeding, Gulf States had filed a lawsuit against Southern in United States District Court for the Eastern District of Texas, requesting that, pursuant to state contract law, it be discharged from all obligations under the Southern contract. Gulf States subsequently received permission from the district court to deposit the sums at issue in the lawsuit with the registry of the court, rather than pay those sums directly to Southern. Gulf States ceased making such deposits when the PUCT and the LPSC barred it from recovering the Southern capacity payments from ratepayers. Thereafter, Gulf States paid Southern an amount equal to the avoided cost of Gulf States' energy purchases. In June 1988, at Southern's request, the Commission suspended the effectiveness of the contract effective July 1, 1988. *Southern Co.*

of those agreements; and (3) issue an order directing Gulf States to show cause why it was not performing under the contract. On August 28, 1986, Gulf States filed a Complaint and Request for Evidentiary Hearing with the FERC asking that the Commission, *inter alia*, (1) declare that the UPS Agreement and relevant part of the Interchange Contract were unjust, unreasonable, unduly discriminatory and preferential, and therefore unlawful and void under Section 206; and (2) void or modify the contract as necessary to bring it into compliance with the Federal Power Act.

Following an 18-day hearing, the presiding administrative law judge issued an Initial Decision concluding that (1) the contract had not been shown to be unjust, unreasonable, unduly discriminatory or preferential, or contrary to the public interest; (2) Gulf States' Complaint should be dismissed; and (3) Southern's Petition should be granted with respect to certain declarations. *Southern Co. Servs., Inc.*, App. 37a at 118a, 39 FERC (CCH) ¶ 63,026, at 65,166-67 (1987).

On April 1, 1988 the Commission issued an Opinion and Order Affirming the Initial Decision in Part, Dismissing Complaint, and Terminating Dockets. App. 4a, 43 FERC (CCH) ¶ 61,003 (1988). The Commission denied the relief requested by Gulf States because, in its view, "mere economic hardship or unforeseen changed circumstances" affecting the buyer are not

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Servs., Inc., 44 FERC (CCH) ¶ 61,290 (1988). In this proceeding, the Commission held that it had jurisdiction over certain issues but declined to consider certain state contract law issues (*Southern Co. Servs., Inc.*, 37 FERC (CCH) ¶ 61,256 (1986)), over which the district court has retained jurisdiction. *Gulf States Utils. Co. v. Alabama Power Co.*, No. B-86-634-CA (E.D. Tex. Jan. 24, 1989). The discussion of Gulf States' potential obligations in this petition in no way waives the Company's position that, as a matter of state contract law, those obligations have previously terminated. The federal statutory standards under § 206 are different, and reflect different interests, from the law of contract. The FERC's obligation under § 206 does not depend upon whether relief is available under the law of contract.

"appropriate considerations" in a Section 206 proceeding in which the buyer seeks contract modification. App. 4a at 12a, 43 FERC (CCH) at 61,014. According to the Commission, "the considerations which [Gulf States] raises are not germane to an assessment of the contracts' justness and reasonableness" and "the question of whether a contract is financially burdensome to the purchaser is distinct from whether the contract is just and reasonable." *Id.* at 15a, 19a, 43 FERC (CCH) at 61,015, 61,017. Accordingly, despite Gulf States' arguments that it was suffering extreme financial hardship, that the contract was a contributing cause of that hardship, and that the contract grossly and inefficiently discriminated in the allocation of benefits and burdens as between the customers of the two systems, the Commission concluded that, as a matter of law, Gulf States had not made a case for relief under Section 206.

The Commission nevertheless purported to examine the merits of Gulf States' claims and concluded that they did not warrant relief. App. 4a at 13a-30a, 43 FERC (CCH) at 61,014-24. It rejected the claim that Gulf States' financial difficulties warranted modification of the Southern contract because, *inter alia*, it believed that those difficulties would be ameliorated if the state commission were to adopt rate relief proposals concerning Gulf States' recently constructed River Bend Nuclear Generating Station. *Id.* at 19a-20a, 43 FERC (CCH) at 61,018. *See infra* n.14. Thus, the Commission left to state agencies the responsibility of ameliorating the hardship imposed by a wholesale contract expressly subject to the Commission's exclusive regulatory jurisdiction. The Commission also rejected the sufficiency of Gulf States' showings concerning the mismatch of benefits and burdens, and the resultant unfairness and inefficiency. On June 1, 1988, the Commission denied Gulf States' Application for Rehearing and adhered to its refusal to reopen the record to admit updated information on state rate relief. App. 33a, 43 FERC (CCH) ¶61,394 (1988).[14]

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[14] Gulf States had moved to reopen the record so that the Commis-

On September 22, 1989, a panel of the United States Court of Appeals for the District of Columbia Circuit denied, without opinion, Gulf States' petition for review of the FERC's April 1, 1988 and June 1, 1988 Orders. App. 1a.[15] On November 27, 1989, the Court of Appeals denied Gulf States' petition for rehearing and suggestion of rehearing *en banc*. App. 2a, 3a.

REASONS FOR GRANTING THE WRIT

Faced with a claim in this case that a whosesale contract for the sale of capacity and associated energy was, as a result of

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sion could consider *current* information establishing, *inter alia*, that the state commissions had rejected the rate moderation plans relating to the River Bend facility. The Commission denied Gulf States' motion to reopen, apparently without considering the factual bearing of this evidence on the lawfulness of the contract. The Commission simply reiterated its "prior conclusion that the utility's financial difficulties arise primarily as a result of problems with the River Bend Nuclear Generating Station and recovery of costs associated with that plant in retail rates, and, therefore, these considerations do not justify altering [Gulf States'] agreements with the Southern Companies." App. 33a at 35a, 43 FERC (CCH) ¶ 61,394 at 62,005. In reaching this conclusion, the Commission failed to consider evidence that, under existing and projected state regulation, while Gulf States could service the River Bend facility (albeit only marginally), it could not also meet its obligations under the Southern contract *and* remain solvent.

The FERC's rejection of the most directly relevant evidence of the contract's impact, and its refusal to reopen the record, violated its duty to consider all relevant evidence even if that evidence was submitted (as here, by necessity) shortly after the close of the administrative hearing. *Office of Communication of the United Church of Christ* v. *FCC*, 425 F.2d 543, 548 (D.C. Cir. 1969); *Scenic Hudson Preservation Conf.* v. *FPC*, 354 F.2d 608, 620 (2d Cir. 1965), *cert. denied*, 384 U.S. 941 (1966); *WMOZ, Inc.* v. *FCC*, 344 F.2d 197, 198 (D.C. Cir. 1965) (per curiam).

[15] The Court of Appeals had jurisdiction of Gulf States' petition for review of the FERC's Orders under 16 U.S.C. § 825*l*. See Rule 14(i) of this Court.

major market changes, unfairly and inefficiently misallocating benefits and burdens between the buying and selling utilities, the FERC held that the claimed "lack of benefits or mismatch between benefits and burdens" on the two systems is not "germane" to the question whether the contract is just, reasonable, non-discriminatory and in the public interest under Section 206 of the Federal Power Act. Further, the Commission asserted that the severe "economic hardship" and "unforeseen changed circumstances" cited by Gulf States are not "appropriate considerations to relieve a party of what it feels is an unfavorable contractual bargain in a section 206 proceeding." App. 4a at 12a-13a, 43 FERC (CCH) at 61,014. And the Commission purportedly declined to decide whether a "*Mobile-Sierra*" public interest argument[16] may be raised by a buyer rather than a seller that seeks to be relieved of contractual obligations, despite the fact that Gulf States' financial hardship bears directly on the public interest.

The FERC's decision is an unexplained and erroneous reversal of course. In two recent decisions with far-reaching ramifications, the FERC asserted responsibility for inter-utility contractual allocations of the enormous costs of baseload capacity among integrated electric utility systems.[17] In so

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[16] Under the *Mobile-Sierra* doctrine, "contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest" (*United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332, 344 (1956)), as where they "might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory" (*FPC* v. *Sierra Pac. Power Co.*, 350 U.S. 348, 355 (1956)).

[17] *Middle South Energy, Inc.*, 31 FERC (CCH) ¶ 61,305, *clarified and reh'g denied*, 32 FERC (CCH) ¶ 61,425 (1985), *aff'd sub nom. Mississippi Indus.* v. *FERC*, 808 F.2d 1525 (D.C. Cir.), *rev'd and remanded in part on other grounds*, 822 F.2d 1104 (D.C. Cir.), *cert. denied sub nom. Arkansas Pub. Serv. Comm'n* v. *FERC*, 484 U.S. 985 (1987); *Nantahala Power & Light Co.*, 19 FERC (CCH) ¶ 61,152, *reh'g denied*, 20 FERC (CCH) ¶ 61,430 (1982), *aff'd sub nom. Nantahala Power & Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

doing, it asserted federal control of such allocations, which have direct effects on interstate wholesale rates and which cannot appropriately be left to the regulatory controls of individual states. This Court effectively confirmed the FERC's exclusive and plenary regulatory control of such allocations in *Mississippi Power & Light Co.* v. *Mississippi*, 108 S. Ct. 2428 (1988), and *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986).

A.

1. The FERC's determination in this case that the altered distribution of benefits and burdens, however burdensome, unfair or inefficient, is not germane under Section 206 has potentially enormous consequences for the future structuring of wholesale transactions between unaffiliated utilities and threatens future investments in investor-owned public utilities, and thus requires this Court's review.[18] For about a decade, utilities in the United States have been building few baseload power plants.[19] Utilities have been deterred from

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[18] The Commission said that it was "sympathetic to the concern that the contracts . . . may not result at the present time in the optimal allocation and use of energy resources," but that such concerns are outweighed in this case "by the goal of promoting contract stability and the other considerations articulated in this Opinion." App. 4a at 23a-24a, 43 FERC (CCH) at 61,020. Earlier in the opinion, however, the Commission had stated that Gulf States' claim that it "can produce energy more cheaply from its own generation than by continuing the purchases from the Southern Companies" was among the considerations that are not "germane" to justness and reasonableness. *Id.* at 13a, 43 FERC (CCH) at 61,014.

[19] Between 1974 and 1984, electric utilities cancelled 97 planned nuclear generating stations and 75 planned coal-fired plants. IPP NOPR, IV *FERC Stats. and Regs.* at 32,106, 32,136 n.22. The total of planned additions to electric generating capacity for the 10-year period beginning in 1988 was 71% less than the planned additions for the prior 10-year period beginning in 1979. This decrease is reflected in an 86% reduction in planned coal-fired capacity additions and an

building either nuclear or coal plants by the risks of regulatory disallowance,[20] environmental concerns, delays, and the huge financial exposure, exacerbated by unpredictable fuel prices and electricity demand.[21] Concerns have been expressed about the adequacy of baseload capacity in numerous regions by the mid-1990s.[22]

85% reduction in planned nuclear capacity additions. *See* American Gas Ass'n, "Trends in Elec. Generation Capacity and the Impacts on Natural Gas Demand" at 1 (Jan. 23, 1989); *see also* North American Electric Reliability Council, *1988 Electricity Supply and Demand* 48-49 (Oct. 1988).

[20] "Unless some new regulatory system is developed, one which provides investors with new assurance that capital prudently committed to the business will be fairly compensated, the United States will find itself with a costlier, expense-intensive, capital-starved power system, to the disadvantage of the consumers whom regulation is designed to protect." J. Kalt, H. Lee & H. Leonard, *Re-Establishing the Regulatory Bargain in the Elec. Util. Indus.* 12 (John F. Kennedy School of Gov't Energy & Envtl. Policy Center Discussion Paper E-87-02 Mar. 1987).

[21] *See* IPP NOPR, IV *FERC Stats. and Regs.* at 32,106; FERC Transmission Task Force, *Electricity Transmission: Realities, Theory and Policy Alternatives* 27 (Oct. 1989) ("FERC Report").

[22] The Energy Information Administration ("EIA") of the Department of Energy projects that 110,000 MW of new electrical generating capacity will be needed by the year 2000. A typical baseload power plant is from 600 to 1,000 MW. According to EIA, 37,000 MW of new generating capacity is currently under construction or planned for by traditional electric utilities, 27,000 MW is projected for non-utility additions and the remaining 46,000 MW is unplanned. Energy Information Administration, *Annual Outlook for U.S. Electric Power 1989* ix-x, 19, 20 (DOE/EIA-0474(89) June 26, 1989). The Commission's Transmission Task Force has adopted these projections. FERC Report at 28-29. The American Gas Association projects that by 1997, 105,000 MW of electrical generating capacity may be required in addition to the plants currently under construction. American Gas Ass'n, *supra* n.19, at 3. *See also* IPP NOPR, IV *FERC*

Utilities contemplating construction of large, baseload plants seek to spread risks by sharing costs. Firm, long-term sales of capacity, of the type at issue here, are a typical way to accomplish that result. Through such means, baseload powerplants of desired scale can be built without any single utility incurring unacceptable risks.[23]

Where the capacity sales contract is between two unaffiliated utilities, each utility will bargain over the allocation of risks, including not only the risk of cost overruns, but market risks such as those involved in this case. For the buying utility, such bargaining has an economic significance quite different from that for the selling utility: a selling utility is entitled to make a profit on the capacity that it sells. Once the FERC approves the capacity sale contract, the selling utility is assured of both a return *of* and a return *on* the capital devoted to the capacity. The return on capital includes both interest on debt and a return on equity. The latter is the selling utility's profit. In contrast, a buying utility makes *no* profit on the resale of power

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Stats. and Regs. at 32,106, 31,137 n.32; *Electric Power Wheeling and Dealing: Technological Considerations for Increasing Competition*, *supra*, at 44-45. "[A]t a national level, there is cause for concern about the ability of the power industry to satisfy electricity demand in the early 1990s without significant increases in prices, shortages, or other draconian measures to limit demand." J. Kalt, H. Lee & J. Hamilton, *A Review of the Adequacy of Elec. Power Generating Capacity in the United States, 1985-93 and 1993-Beyond* 47 (John F. Kennedy School of Gov't Energy & Envtl. Policy Center Discussion Paper E-86-09 June 1986). "Demand growth nationally of the type projected by [the Department of Energy] . . . would lead to national reserve margins . . . below the 20% figure commonly used in the power industry as a minimum measure of service reliability." *Id.* at 44-45.

[23] Among recent cases decided by this Court, both *Mississippi Power and Light*, *see supra* at 14-15, and *Duquesne Light Co. v. Barasch*, 109 S. Ct. 609 (1989), arose out of sharing by utilities of the costs of baseload power plants.

purchased under a firm capacity contract. There is no mark-up on purchased power; the buying utility simply passes through the costs of its purchased power.[24] It is entitled to include in its rates the cost of its purchased power, but no more. Further, the buying utility retains the risk that, even after the FERC approves the capacity sale contract, when the utility attempts to resell the purchased power, the FERC (or a state agency if the resale is at retail), will disallow some or even, as here, all of the purchased power costs on any of a variety of grounds, under evolving (and increasingly unpredictable) standards of "prudency" or "used and useful." *See supra* n.12.[25]

In short, while the selling utility will ordinarily make a profit and faces no further regulatory risk once the capacity sale contract is approved by the FERC, the buying utility is placed in the "one-way ratchet" of never being able to profit on a capacity sale contract but facing substantial regulatory risk of disallowance. For the buyer, the capacity sale contract is an opportunity to lose money, but not to make it. As the actions of the LPSC and PUCT in this case show, the buying utility faces disallowance by reason of changed market conditions (such as changes in fuel prices and electricity demand) that are beyond its control.

In a free market, a buyer, like a seller, would have an opportunity to profit as well as to lose. Thus, over time a competent buyer recoups losses. Investors are attracted by the expectation of profit, which is consistent with coming out ahead on some contracts and behind on some others. The cost of equity

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[24] *See* 18 C.F.R. § 35.13(b)(8)(vi); 18 C.F.R. § 35.14(a)(2)(iii); Order No. 352, 48 Fed. Reg. 55,429 (Dec. 13, 1983).

[25] Gulf States has consistently maintained that the FERC's plenary regulatory power and responsibility over wholesale contracts preempts state commission disallowance of FERC-approved contract charges. That issue is presented in the pending appeals from the PUCT and LPSC disallowances; it was not involved in the proceedings below and is not presented here.

capital is a measure of the investor's perception of the likelihood that over time there will be more positive than negative outcomes.

As we have shown, however, for the buyer of firm capacity, there is no such opportunity to balance losses with gains. A regulated buyer can pass through only the costs of purchased power and no more. On its face, the case for the FERC's "plenary power" to assess the impact of changed market conditions on buyers is, if anything, stronger than the case with respect to sellers. Yet the FERC has drawn the opposite distinction.

The FERC has simply ignored the asymmetry in the underlying regulatory treatment of the buyer and seller. The net result is that the buying utility faces the risk that the states or the FERC will not let it recover the costs of its purchased power; the standard regulatory treatment of purchased power denies the buyer a profit when it makes a correct decision to buy; and the FERC's ruling denies the buyer relief when the decision turns out to be wrong by reason of market changes beyond the buyer's control that result in an inefficient mismatch of benefits and burdens.

Such a result has potentially profound adverse consequences, which the FERC never addressed. Utilities must serve, and therefore they must buy or build capacity. The one-way ratchet, which the FERC's legal determination exacerbates, eventually must affect investor perceptions and the flow of capital to this industry. Investors may insist upon higher risk premiums before investing in utilities that seek to purchase a large portion of their capacity requirements. Inefficient incentives may arise for utilities to build rather than to purchase capacity. The Commission's narrow reading of its statutory authority renders altered benefits and burdens irrelevant, and leaves unpredictable market risks entirely on the buyer. The Commission's action can only further discourage potential

buyers from purchased power arrangements, with a consequent loss of efficiencies.[26]

The adequacy of electric supply, the efficiency of the electric utility industry, and the response of the capital markets to this industry have far-reaching ramifications for the quality and cost of service to consumers. In light of the possible consequences, the question whether the impact of market changes, beyond the control of either party, upon the relative benefits and burdens on the buyer and seller is germane under Section 206 requires an authoritative statutory interpretation, which can come only from this Court. It is simply too important to be left to any other forum.[27]

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[26] The Commission must of course weigh countervailing interests of sellers, but the issue here is relevance, not weight.

[27] The Commission purported to evaluate the facts with respect to benefits and burdens, which it had determined were legally irrelevant, and financial hardship to the buyer, as to which the Commission both explicitly declined to decide relevance and stated that such hardship is not an "appropriate consideratio[n]" for relief from a contract in a § 206 proceeding. *See* App. 4a at 12a, 43 FERC (CCH) at 61,014. Given these erroneous and confused legal determinations, the Commission's purported assessment of the facts should not cause the Court to decline review. The agency's weighing of facts, and its subsidiary legal determinations (for example, the standard for finding whether the contract "caused" Gulf States' financial difficulties, *see* App. 4a at 19a-20a, 43 FERC (CCH) at 61,018), are inevitably colored by its view of statutory relevance. An agency simply will not examine a factor that it has already rejected as irrelevant in the same way that it will examine a factor it accepts as relevant. An agency's discussion of facts should not insulate its erroneous legal determinations from review by this Court. The Court should reverse and remand for consideration of the merits in light of the *correct* legal principles. *See Schwabacher* v. *United States*, 334 U.S. 182, 201-02 (1948).

The importance of a resolution by this Court of the legal question in this case, notwithstanding the FERC's purported examination of the facts, is underscored by a recent report to the Administrative Con-

2. The FERC's narrow reading of its statutory responsibilities is not an isolated case. Recently, the Commission was asked by a buying utility to find that a contract for baseload power, prudent when negotiated, had become unjust and unreasonable by reason of market changes. The contract rates had become vastly greater than the cost of power available elsewhere. *Public Serv. Co. of New Mexico*, 43 FERC (CCH) ¶61,469 (1988), *petition for review pending sub nom. San Diego Gas & Elec. Co.* v. *FERC*, No. 88-1744 (D.C. Cir. filed Oct. 17, 1988). In denying relief, the Commission cited as "dispositive" its opinion denying relief in the instant case to petitioner Gulf States. *Id.* at 62,152. The Commission also quoted an earlier unreviewed case (as it did here) in which it had stated that "[w]e do not view our responsibilities under the Federal Power Act as including a determination that the purchaser has purchased wisely or has made the best deal available." *Id.* (quoting *Pennsylvania Power & Light Co.*, 23 FERC (CCH) ¶61,325 (1983) ("*PP&L*")).[28] Thus, the Commission is rapidly embedding in its case law a hands-off position that has far-reaching ramifications for the electric utility industry.

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ference of the United States. The report found, on the basis of empirical research, that with respect to cases decided after this Court's decision in *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837 (1984), lawyers for the private parties reported that there were "major changes" by the agency in about 37 percent of remands, and that the practical effect on the private parties of the agency's decision on remand was "much more favorable" in about 40 percent of the remands than was the decision before remand. P. Schuck and E. Elliott, *To the Chevron Station: An Empirical Study of Fed. Admin. Law* 89-90, 92-93 (Sept. 18, 1989) (Report to the Administrative Conference Under Contract Number AC 8702013). These results did not significantly depend upon whether the remand was because the agency had insufficiently explained its decision or because it had committed legal error. *Id.* at 89-90. Typically, the agency relied upon the old record in reaching the new results. *Id.* at 90.

[28] We show below that the Commission's reliance on *PP&L* is misplaced.

3. In two celebrated cases, *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956), *see supra* n.16, this Court granted *certiorari* to determine the opportunity of sellers, under the Natural Gas Act and the Federal Power Act, to be relieved of obligations under contracts that, over time, had become unjust and unreasonable. This Court granted the writ "because of the importance of the questions involved in the administration of the Federal Power Act." 350 U.S. at 352. The issue from the perspective of buyers is equally important.

4. This Court's review is particularly necessary here because the FERC has repudiated rather than asserted its responsibility for ensuring that contracts remain in the public interest in the aftermath of major market changes. In the "take-or-pay" cases involving the natural gas industry, the FERC has been repeatedly instructed that it may not refuse to take responsibility for protecting the public interest in the face of economic dislocation arising from major changes in market conditions. In these cases, numerous pipelines had entered into long-term, "take-or-pay" contracts with producers at a time when deliverable gas supplies were short.[29] Subsequently, supplies increased dramatically and prices fell. The result was widespread economic disruption, inefficiency and financial hardship to buying utilities, some of which would ultimately be borne by consumers.

The Commission nevertheless attempted to deny its responsibilities. In *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1044 (D.C. Cir. 1987), *cert. denied sub nom. Interstate Natural Gas Ass'n* v. *FERC*, 485 U.S. 1006 (1988), the court of appeals remanded a major rulemaking to the FERC, finding that the FERC's "apparent insouciance on take-or-pay taints the package." Two years later, on review of the Commission's

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[29] A buyer under such a contract must pay for specified minimum volumes at the contract price, whether or not the buyer actually takes such volumes.

action on remand, the court of appeals found that the Commission had not yet addressed the take-or-pay problem; had "done nothing" to explain its reasons for inaction so the court could review them; and was nevertheless defending its position with the "utmost complacency." *American Gas Ass'n* v. *FERC*, 888 F.2d 136, 148 (D.C. Cir. 1989). The court found that the Commission's "half-explained cunctation" revealed its "dilatory tactics." *Id.*[30] The court concluded that the FERC could not escape its duty to decide whether or how to modify these contracts that had become uneconomic to buyers "by avoiding the issue whilst time and the workings of its interim rule conspire to moot the issue." *Id.* Similarly, in this case, the FERC has not fulfilled its regulatory mission. Review by this Court is particularly appropriate, given the similar nature of the issue here.

B.

The Commission failed adequately to explain its determination that a lack of benefits or an inefficient mismatch between benefits and burdens on the buying and selling systems is not relevant under Section 206. Further, the Commission's determination was wrong.

1. The Commission did not attempt to find any support in text or legislative history for its interpretation, nor could it. Section 206 states in pertinent part that "*[w]henever* the Commission . . . shall find that *any* . . . *contract* affecting [a jurisdictional] rate . . . is unjust, unreasonable, unduly discriminatory or preferential, the Commission *shall* determine the just and reasonable . . . contract to be thereafter observed and in force. . . ." (emphasis added). This language,

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[30] It bears mention that the FERC's predecessor, the Federal Power Commission, erroneously declined jurisdiction as to the most momentous regulatory issue of an earlier day. *See Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954) (jurisdiction over wellhead sales of natural gas).

"without qualification or exception," *Permian Basin Area Rate Cases*, 390 U.S. 747, 783-84 (1968), requires "contracts" to be just and reasonable. Except for the unusual case where a buyer and seller make a contract that imposes costs on third parties, a contract can be unreasonable *only* if it is unreasonable to the buyer or the seller. The statute makes no distinction between buyers and sellers. Neither does it limit the Commission's authority to a particular time, for example, the time of initial approval, or the time when a buyer attempts to resell purchased power at wholesale. The Commission must act "whenever" it finds a contract to be unjust or unreasonable. There is nothing in the text to suggest that a factor relevant to justness or reasonableness at one time may become legally irrelevant at another time (although, of course, a relevant factor might over time be weighed differently relative to other relevant factors, such as contract stability).[31]

Instead of examining the language or legislative history of Section 206, the Commission based its determination of irrelevance solely upon two unreviewed Commission decisions. *See* App. 4a at 15a-16a, 43 FERC (CCH) at 61,015-016 (quoting *Philadelphia Elec. Co.*, 15 FERC (CCH) ¶ 61,264 (1981), and *Pennsylvania Power & Light Co.*, 23 FERC (CCH) ¶ 61,325 (1983)). Neither of these unreviewed cases examined the text or legislative history of Section 206. In any event, whether or not these cases were correctly decided, they involved a fundamentally different issue from that presented by Gulf States' claim for relief. In both cases, the contracts were before the Commission for initial approval. The Commission said that it would not, as part of that determination, examine the buyer's prudence in entering the contracts (for example, whether it needed the power or could have obtained the power more

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[31] We do not address the weight to be given to inefficient or unfair changes in the distribution of benefits and burdens on the buying and selling systems, as against other relevant factors such as stability of contract. The only question presented by the Commission's opinion in this case is whether the factor is germane at all under § 206.

cheaply elsewhere). The issue in this case is not whether Gulf States was prudent in entering into the contract, but whether changed circumstances have caused the contracts to become unjust, unreasonable or contrary to the public interest.[32] In neither of the two cases relied upon by the Commission had there been any market changes between the signing of the contract and the Commission's initial approval. Each party therefore was getting what it had bargained for. Here, the Commission has declined to protect the buyer from subsequent market changes beyond the buyer's control. In short, the Commission relied upon an insufficient legal basis for its determination that an unintended and inefficient mismatch of benefits and burdens radically altered by major market changes is not even relevant under Section 206.

Moreover, the FERC chose a rule of decision—that the mismatch of benefits and burdens is not germane—without any explanation of how that interpretation advances, or is even consonant with, statutory objectives. The FERC tightened the one-way ratchet on the buyer of capacity without any consideration of the potential effects of that rule of decision on the ability of the industry to attract capital, or on skewing of buy-versus-build incentives.[33] Yet capital-attraction and the

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[32] Indeed, the Commission itself recognized that prudency "was not at issue," App. 4a at 17a n.12, 43 FERC (CCH) at 61,016 n.12, yet it relied for its legal determination exclusively on the two cases we discuss in text, which involved circumstances at the time the contract was entered into, and not circumstances arising from subsequent market changes.

[33] The effects on the industry of the FERC's rule of decision are different from the effects on Gulf States in this particular case. *See* 2 K. Davis, *Administrative Law Treatise* § 12:3 at 413 (2d ed. 1979) (distinguishing between "legislative" and "adjudicative" facts); *Industrial Union Dep't, AFL-CIO v. Hodgson*, 499 F.2d 467, 474 (D.C. Cir. 1974).

avoidance of incentives for inefficient behavior are among the FERC's primary statutory responsibilities.[34]

2. In addition to being inadequately explained, the Commission's decision is wrong.[35] We have already pointed out that the Commission's determination of irrelevance is a "qualification or exception" that is without warrant in the language of Section 206. Moreover, the Commission explicitly declined even to attempt to reconcile its position with this Court's decisions in *Mobile-Sierra*. *See* App. 4a at 12a, 43 FERC (CCH) at 61,014. In those cases, this Court read the Act (and the same language in the Natural Gas Act) to achieve a "reasonable accommodation between the conflicting interests of contract stability on the one hand and public regulation on the other," because "contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest." *United Gas Pipe Line Co.*, 350 U.S. at 344. The public interest could be impaired, the Court said,

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[34] *See, e.g.*, *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603, 605 (1944). While capital-attraction has typically been emphasized in rate cases, capital-attraction can also be impaired by rules governing purchase obligations.

[35] Whether contract modification is determined by application of a "just and reasonable" standard or the more rigorous "public interest" standard depends upon whether the parties reserved in the contract itself the right to seek modification from the Commission. *Kansas Cities* v. *FERC*, 723 F.2d 82, 87-88 (D.C. Cir. 1983) (Scalia, J.). If they did, the "just and reasonable" standard applies. In this case, the presiding administrative law judge concluded that it was appropriate to review the contract under the "just and reasonable" standard. App. 37a at 57a, 39 FERC (CCH) at 65,142. The Commission expressly declined to decide which standard applied. App. 4a at 11a n.7, 43 FERC (CCH) at 61,013 n.7. This Court need not decide which standard applies in order to decide the question tendered in this petition, that is, the threshold *relevance* of an unintended, unfair and inefficient alteration in benefits and burdens resulting from changes in market conditions. The Commission held that such facts are irrelevant under either standard.

where a contract "might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." *Sierra Pac. Power*, 350 U.S. at 355. Contrary to the FERC's understanding, *see* App. 4a at 12a n.9, 43 FERC (CCH) at 61,014 n.9, the Court did not purport to enumerate exhaustively the factors relevant to whether a previously approved contract is unjust or unreasonable, nor did it suggest that only sellers could invoke Section 206 to be relieved of contractual obligations so uneconomic as no longer to be in the public interest. Moreover, the radical alteration of burdens under the instant contract does "impair the financial ability of the public utility [Gulf States] to continue its service."[36]

The teaching of *Sierra* is that "the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." *Permian Basin*, 390 U.S. at 784; *see also Borden, Inc.* v. *FERC*, 855 F.2d 254, 263 (5th Cir. 1988) ("these contractual rights were always subject to being overridden by the Commission in the public interest"); *United Gas Pipe Line Co.* v. *FERC*, 824 F.2d 417, 427 (5th Cir. 1987) ("the Commission may curtail deliveries of gas according to priorities it determines to be in the public interest, whether or not the priorities correspond to those created by contract"). The Commission's narrow reading of Section 206 cannot be squared with its "paramount" and "plenary" power,

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[36] The Commission was influenced in its decision by the possibility that the state commissions that regulate Gulf States would provide it with rate relief. *See* App. 4a at 20a, 43 FERC (CCH) at 61,018. Such reliance was inconsistent with the Commission's own statutory responsibility to ensure that contracts affecting wholesale rates are just and reasonable. Subsequently, the state commissions denied relief. The Commission denied Gulf States' petition to reopen, saying that the new developments did not justify relief. *See supra* n.14. This later statement cannot negate the Commission's earlier reliance on the prospect of state relief.

long ago recognized by this Court, to ensure that contracts remain in the public interest.[37]

Mississippi Industries (*see supra* n.17) also involved the allocation of capacity costs among utilities. The issue was not the level of rates in relation to costs. The issue was the quantity of capacity that each utility was to be required to pay for, whether or not the utility actually bought energy generated by that capacity. That is the issue in this case. The Commission in *Mississippi Industries* determined, and the court of appeals agreed, that a mismatch of burdens is relevant under Section 206, and that in the case of integrated utilities, equity or fairness is the appropriate criterion.[38] In the present case, the Commission ruled that a mismatch of burdens between non-integrated utilities is not relevant. Where, however, the mis-

[37] The Commission argued in the Court of Appeals that the *only* criterion for determining whether a rate is just and reasonable is the seller's cost of generating the power and that all other considerations (e.g., those involving the purchaser) are irrelevant. Brief for Respondent Federal Energy Regulatory Commission at 17-18, *Gulf States Utils. Co.* v. *FERC*, No. 88-1549 (D.C. Cir. filed June 9, 1989). This Court has made clear that, while supplier costs are important, the Commission is both authorized and *required* to consider non-cost factors. *Permian Basin*, 390 U.S. at 815 & n.98; *cf. FPC* v. *Conway Corp.*, 426 U.S. 271, 279 (1976) (rate can be unreasonable because of anticompetitive price squeeze, even if reasonable in relation to seller's costs). The Commission has elsewhere recognized that a "variety of non-cost-based factors may be used in determining a just and reasonable rate under the NGA." Ceiling Prices; Old Gas Pricing Structure, 51 Fed. Reg. 22,168, 22,171 (1986).

[38] The Commission acted, the court said, "to insure an equitable distribution. This equitable distribution is mandated by the [Act] because of the historical integration of the MSU system." *Mississippi Industries*, 808 F.2d at 1540-41. The contract had "created serious inequities in the division of costs of power resources among the operating companies. . . ." *Id.* at 1541; *see also id.* at 1556-57. The Commission said that it was choosing the "most equitable allocation proposal." *Middle South Energy, Inc.*, 31 FERC (CCH) ¶ 61,305 at 61,655.

match between such parties is the result of market changes beyond the control of either party, both inefficiency and unfairness can result. The Commission offered not a word of explanation why unfairness and inefficiency are irrelevant as between non-integrated utilities. Under a correct reading of the statute, both are surely relevant.

In other contexts, the Commission has recognized "its continuing obligation . . . to assure the most efficient . . . allocation of wholesale electric energy in order to provide the lowest cost and reliable energy to consumers." IPP NOPR, IV *FERC Stats. and Regs.* (CCH) ¶32,456 at 32,103. With respect to unaffiliated buyers and sellers, the Commission has held that a contract can be unjust and unreasonable because it forecloses the buyer from cheaper options. In 1984, the Commission eliminated minimum commodity bills from a large number of pipeline service agreements to the extent that these provisions permitted the recovery of variable costs.[39] Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, 49 Fed. Reg. 22,778 (1984). The Commission found these provisions to be unjust and unreasonable in part because the inclusion of variable costs in minimum bills prevented customers from purchasing natural gas from other, cheaper sources that became available when changing economic circumstances created surplus of supply. *Id.* at 22,783. The Commission therefore sweepingly abrogated these provisions in any contract or tariff where they might be found.[40] Inexplicably, the Commission determined in the pres-

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[39] Minimum bills generally require the customer to pay certain fixed and variable costs for a portion of the natural gas to which the customer is contractually entitled, whether or not the customer actually takes that volume of gas.

[40] On appeal, the D.C. Circuit dismissed as "frivolous" the argument that the Order impermissibly altered the terms of existing contracts, citing the Commission's authority under § 5(a) of the Natural Gas Act, 15 U.S.C. § 717(a), the Natural Gas Act analog to § 206 of the Federal Power Act, to modify contract terms it determines to be

ent case that the greater efficiency of alternative sources, which resulted from market changes beyond the buyer's control, was not germane. The Commission was wrong.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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unjust and unreasonable. *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1153 n.9 (D.C. Cir. 1985), *cert. denied sub nom. Transwestern Pipeline Co.* v. *FERC*, 476 U.S. 1114 (1986). It is well recognized that the two sections are generally to be construed *pari passu*. *See, e.g., Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 n.7 (1981).

APPENDIX

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 88-1549
September Term, 1989

GULF STATES UTILITIES COMPANY, *Petitioner*
v.
FEDERAL ENERGY REGULATORY COMMISSION

Petition for Review of Orders of the Federal Regulatory Commission

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Before: RUTH B. GINSBURG, SILBERMAN, and D.H. GINSBURG, Circuit Judges.

Filed Sep 22, 1989

JUDGMENT

This case was considered on the record from the Federal Energy Regulatory Commission and on the briefs and oral arguments of counsel. Upon full review of the parties' presentations, the court is satisfied that appropriate disposition of the petition does not warrant an opinion. *See* D.C. Cir. R. 14 (c). Substantially for the reasons stated by the Commission, it is

ORDERED and ADJUDGED that the Commission's April 1, 1988 and June 1, 1988 orders be affirmed.

The Clerk is directed to withold issuance of the mandate herein until seven days after disposition of any timely petition for rehearing. *See* D.C. Cir. R. 15(b)(2).

Per Curiam
FOR THE COURT
/s/ Constance L. Dupré
CONSTANCE L. DUPRE, CLERK

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 88-1549
September Term, 1989

GULF STATES UTILITIES COMPANY,
Petitioner

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

Before: RUTH B. GINSBURG, SILBERMAN, and D.H. GINSBURG, Circuit Judges.

Filed Nov 27, 1989

ORDER

Upon consideration of Petitioner's Petition for Rehearing, filed November 6, 1989, it is

ORDERED, by the Court, that the petition is denied.

Per Curiam
FOR THE COURT
CONSTANCE L. DUPRE, CLERK
/s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 88-1549
September Term, 1989

GULF STATES UTILITIES COMPANY,
Petitioner

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

Before: WALD, CHIEF JUDGE; MIKVA, EDWARDS, RUTH B. GINSBURG, SILBERMAN, BUCKLEY, WILLIAMS, D.H. GINSBURG and SENTELLE, Circuit Judges

Filed Nov 27, 1989

ORDER

Petitioner's Suggestion For Rehearing *En Banc* has been circulated to the full Court. No member of the Court requested the taking of a vote thereon. Upon consideration of the foregoing it is

ORDERED, by the Court *en banc*, that the suggestion is denied.

Per Curiam
FOR THE COURT
CONSTANCE L. DUPRE, CLERK
/s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

Chief Judge Wald did not participate in this matter.

FERC REPORTS

Commission Opinions, Orders and Notices

[¶ 61,003]

Southern Company Services, Inc., Docket No. EL86-53-001;

Gulf States Utilities Company v. Southern Company Services, Inc. et al., Docket No. EL86-57-001

Opinion No. 300; Opinion and Order Affirming Initial Decision in Part, Dismissing Complaint, and Terminating Dockets

(Issued April 1, 1988)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon and Charles A. Trabandt.

[Note: Initial Decision of the presiding administrative law judge on petition for declaratory orders and on complaint issued May 12, 1987, appears at 39 FERC ¶ 63,026.]

Appearances

Cecil L. Johnson, William Warfield Ross, Shira D. Modell, William L. Powers, Jane Seigler, Paul W. Gertz, Tom F. Phillips, and *Fredrick R. Tulley* Gulf States Utilities Company

Charles M. Crook, Rodney O. Mundy, James H. Miller, III, and *Dan H. McCrary* on behalf of Southern Company Services, Inc. and Alabama Power Company

Robert H. Forry on behalf of Georgia Power Company

G. Edison Holland, Jr. on behalf of Gulf Power Company

Ben H. Stone on behalf of Mississippi Power Company

N. Beth Emery and *William D. DeGrandis* for Oglethorpe Power Corporation

Frederick H. Ritts and *Garrett Stone* for Sam Rayburn Generation and Transmission Cooperative, Inc.

Robert A. O'Neil and *Mary A. Hekman-Lielbriedis* for Brazos Electric Power Cooperative, Inc.

Wallace E. Brand on behalf of the Towns of Erath *et al.*, Louisiana

William A. Chesnutt on behalf of the Gulf States Energy Users Group

Frank J. Uddo, Ted Jones, and *Elizabeth Porter* on behalf of the Louisiana Public Service Commission

William James Sanford, Jr. made a special appearance on behalf of the Alabama Public Service Commission

Charles F. Reusch, Theresa J. Burns, and *C. Stephen Angle* on behalf of the Staff of the Federal Energy Regulatory Commission

[Opinion No. 300 Text]

This Opinion addresses an initial decision issued on May 12, 1987. *Southern Company Services, Inc. et al.*, 39 FERC ¶ 63,026. In that decision, the presiding judge found that Gulf States Utilities, Inc. (GSU) had failed to establish that contracts which provide for the purchase of capacity and energy from the members of The Southern Company system (Southern Companies)[1] warranted modification pursuant to section

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[1] The Southern Company is a holding company registered under the provisions of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 *et seq.* (1982). Four wholly owned subsidiaries—Alabama Power Company, Georgia Power Company, Gulf Power Company, and Mississippi Power Company—operate electric utility facilities on an integrated basis. Southern Company Services, Inc. provides engineering, accounting, and other services on behalf of the operating utilities. The four operating utilities and Southern Company Services, Inc. are signatories to the contracts with GSU.

206(a) of the Federal Power Act (FPA or Act).[2] In addition, the presiding judge interpreted certain disputed provisions of the parties' contracts.

Exceptions to the initial decision were filed by GSU, the Southern Companies, the Louisiana Public Service Commission (Louisiana Commission), Sam Rayburn Generation & Transmission Electric Cooperative, Inc. (SRG&T), Brazos Electric Cooperative, Inc. (Brazos), and the Commission's trial staff (Staff). For the reasons stated below, we shall, as to GSU's complaint, affirm the initial decision and dismiss it. As to the contract interpretation matters set for hearing, we shall affirm several of the presiding judge's rulings, but find it necessary to resolve other questions decided in the initial decision.

Background and Procedural History

GSU and Southern Companies are signatories to two agreements at issue in this proceeding. One is an agreement for the sale of firm capacity from ten coal-fired generating units by the Southern Companies to GSU (the UPS agreement). The UPS agreement, originally executed in February 1982, was amended in May 1982 and again in December 1983. The UPS agreement currently provides for the sale of capacity as follows:

1985—400 MW

1986—500 MW

1987—600 MW

1988-1992—700 MW

The capacity and energy sold under the UPS agreement is priced pursuant to a cost-of-service formula rate which reflects the costs of the specific plants from which the sales are made.

The second contract, the Interchange Contract, contains a rate schedule designated as Schedule E. Schedule E was added

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[2] 16 U.S.C. § 824e(a) (1982).

to the Interchange Contract when the UPS agreement was amended in December 1983. Schedule E provides for the sale of "long term power" by the Southern Companies to GSU, i.e., capacity and energy not needed to meet the formers' system requirements or to meet commitments to other utilities. The capacity is priced on the basis of the Southern Companies' embedded cost of coal-fired generation, and the energy is priced on the basis of incremental costs. Section 2.2.4 of the UPS agreement provides for the substitution of UPS capacity in lieu of Schedule E capacity in the event that the avoided cost of oil and gas-fired energy to GSU exceeds the composite average cost of capacity and energy from the Southern Companies. The total mix of capacity to be provided under these two agreements during any given year is 1000 MW.

The history of the parties' negotiations as to these agreements is more fully set forth in the initial decision, 39 FERC at pp. 65,136-139. Since GSU originally entered into the UPS agreement, its need for capacity has lessened. In addition, the cost advantage provided by coal-fired generation over GSU's (oil and gas-fired) capacity has diminished or disappeared. GSU has also encountered financial difficulties in the course of constructing the River Bend Nuclear Generating Station. In 1985 and 1986, GSU and the Southern Companies entered into negotiations as to modifications of the agreements at issue. In July 1986, GSU filed suit in federal court,[3] raising various state contract law and tort claims. In response, the Southern Companies filed a petition for a declaratory order (Docket No. EL86-53-000), requesting that we assert exclusive or primary jurisdiction over the parties' dispute and interpret the agreement at issue. GSU, in turn, filed a complaint (Docket No. EL86-57-000), alleging that the UPS agreement and Schedule E were unjust, unreasonable, unduly discriminatory or preferential and requested appropriate relief. By order issued on December 15, 1986, the Commission, inter alia, asserted pri-

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[3] *Gulf States Utilities Co.* v. *Alabama Power Co.*, No. B-86-634-CA (E.D. Tex).

mary jurisdiction over portions of the parties' court dispute, set GSU's complaint and certain contract interpretation matters for hearing, and consolidated the two dockets. 37 FERC ¶ 61,256.

The Initial Decision

In his initial decision, the presiding judge determined that it was appropriate to investigate the rates and charges in the parties' contracts under the usual "just and reasonable" standard and, citing the decision in *Papago Tribal Utility Authority* v. *FERC*, 723 F.2d 950 (D.C. Cir. 1983), the Commission's "indefeasible right" to alter any rate or charge which is contrary to the public interest.

GSU, SRG&T, and the Louisiana Commission did not claim that the Southern Companies were earning in excess of their costs of service (including a reasonable return); rather, they alleged that non-cost considerations rendered the agreements unjust and unreasonable. These considerations included: (1) the occurrence of "unforeseen circumstances;" (2) the allocation of benefits and burdens under the contracts; (3) GSU's financial condition; (4) GSU's inability to recover the full cost of the capacity in its retail rates due to unfavorable state regulatory decisions; (5) the Southern Companies' alleged lack of reliance on the UPS agreement; (6) the Southern Companies' need for the capacity; (7) the relative size of the Southern Companies and GSU; and (8) the existence of inefficiencies in the allocation of energy resources as a result of the contracts. The presiding judge found that the parties had failed to substantiate the allegations and/or he found that these non-cost considerations were irrelevant to the justness and reasonableness of the agreements.

In addition, the presiding judge interpreted various provisions of the parties' contracts, as directed by the Commission. In particular, he found that section 2.2.1 of the UPS agree-

ment[4] imposes an obligation upon the parties to negotiate in good faith and with diligence which is not limited by section 2.2.4 of the UPS agreement.[5] However, he determined, the provision does not provide a contractual basis for relief by the Commission of GSU's obligations; rather, relief depends upon a favorable finding under section 206(a) of the Federal Power Act.

Exceptions

With respect to GSU's complaint, the utility, SRG&T, Brazos, and the Louisiana Commission except to the initial decision. They contend that the parties' contracts expressly provide for Commission review of GSU's capacity purchase obligation, and that the Commission may modify the obligation pursuant to its authority under section 206(a) of the Federal Power Act. Whether the parties' contracts are unjust and unreasonable, GSU *et al.* contend, is not confined to an exam-

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[4] Section 2.2.1 of the UPS agreement provides:

In the event either party desires to increase or decrease capacity sales or purchases for the years set forth above, the parties agree to negotiate in good faith and with diligence to proceed to evaluate alternatives which may reasonably provide for such desired change in capacity; provided, that no such change shall be made except upon mutual written agreement of the parties hereto.

[5] Section 2.2.4 provides, in relevant part:

Recognizing that the parties have amended Section 2.2 of the Agreement to reduce the unit power capacity to be sold by Southern Companies and purchased below that amount which was contained in the Agreement, and have further provided, in substitution, for the reduction in unit power capacity, for the sale by Southern Companies and the purchase by GSU of less expensive capacity and energy . . . the parties agree that the amount of unit power capacity to be purchased under Section 2.2 in each contract period by GSU is subject to being increased (but in no event decreased) beginning January 1, 1987 . . . should there be changes in circumstances as described below. . . .

ination of the seller's cost of service (including a reasonable return). The Federal Power Act, they argue, encompasses concerns other than recovery by a regulated utility of its costs. GSU requests that the UPS agreement and Schedule E be modified so that (1) the utility is required to purchase energy from the Southern Companies only when the price is at or below its avoided cost and (2) the Southern Companies are allowed to recover capacity charges only to the extent that the total amount charged for capacity and energy does not exceed GSU's avoided cost.

The Southern Companies and Staff oppose GSU and its supporters. They contend that the parties' contracts do not expressly provide for Commission review of the GSU's obligation to purchase capacity under the usual "just and reasonable" standard, and that the Commission may not employ non-cost factors to reduce the Southern Companies' rates below their cost of service. This, the Southern Companies claim, would amount to a confiscation of their property in violation of the Constitution. Furthermore, the Southern Companies and Staff argue, GSU has not established that the contracts in dispute are unjust, unreasonable, unduly discriminatory or preferential, or otherwise contrary to the public interest under the Federal Power Act.

Discussion

1. GSU's Section 206 Complaint

We have carefully reviewed the initial decision, the parties' briefs, and the evidentiary record. Based upon our review, we affirm the presiding judge's determination that grounds for modification of the Southern Companies-GSU contracts pursuant to section 206(a) of the FPA have not been established.[6] [7]

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[6] We note in passing that the presiding judge ruled that GSU bore the burden of proof in support of its section 206(a) claim. As the proponent of an order from the Commission, GSU's burden is one of

We summarily affirm the initial decision's determination, for the reasons stated therein, that the pricing mechanism in the UPS contract is not unjust, unreasonable, unduly discriminatory or preferential (39 FERC at pp. 65,164-65). We also affirm and adopt those portions of the initial decision which address the following considerations in support of GSU's section 206(a) claim; unforeseen changed circumstances (39 FERC at p. 65,149);[8] the comparative sizes of the Southern Companies and GSU (39 FERC at p. 65,155); equitable considerations (39 FERC at pp. 65,156-157); and the effect of state commission decisions upon the justness and reasonableness of the parties' agreements (39 FERC at p. 65,163). As to the other non-cost factors cited by GSU, we agree with the presiding

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going forward with evidence in support of a *prima facie* case, not the burden of ultimate persuasion. *Southern California Edison Co.*, Opinion No. 289, 41 FERC ¶ 61,188 (1987). We need not determine if GSU has met its burden, since our decision is based on all the evidence submitted by the participants.

[7] As indicated, the participants disagree as to whether the parties' contracts contemplate Commission review of the quantity of capacity purchased under the agreements at issue, whether such review is to be conducted under the normal "just and reasonable" standard or a stricter, "public interest" standard, and whether the Commission possesses the authority under the FPA to abrogate or modify GSU's capacity purchase obligation in the circumstances of this case. We find it unnecessary to decide the first two questions. Our conclusion that GSU has not made a case for relief would be the same regardless of which standard applies. As to the third question, it is moot in light of our determination that no modification or abrogation of the contracts is warranted.

[8] On exception GSU now maintains that whether the "changed circumstances" were foreseeable is irrelevant to the authority of the Commission to reform an unjust and unreasonable contract, citing *Mississippi Industries* v. *FERC*, 808 F.2d at 1558, *reversed and remanded in part on other grounds*, 822 F.2d 1104 (D.C. Cir. 1987). GSU is correct; nonetheless, this does not detract from the validity of the presiding judge's conclusion that the changed circumstances alleged to be unforeseen do not support GSU's claim for relief.

judge, for the reasons stated below, that they also do not support the utility's request for relief. Before addressing these other factors, however, some general comments are in order.

The gravamen of GSU's case for relief is that circumstances have changed since it signed and later amended the agreements with the Southern Companies, particularly the need for the capacity provided under the contracts and the benefits realized by obtaining coal-fired energy in lieu of GSU's gas-fired generation. These circumstances and the difficulties encountered in connection with the River Bend Nuclear Generating Station, GSU alleges, threaten the utility's financial solvency and ability to continue providing service to its customers. The utility, citing the *Mobile-Sierra*[9] doctrine, contends that the effect of continuation of its agreements with the Southern Companies in their present form is relevant to a determination of whether those contracts are presently unjust and unreasonable.

In determining whether a contract is unjust, unduly discriminatory or preferential under section 206(a) of the Federal Power Act, we do not believe that mere economic hardship or unforeseen changed circumstances, of the type alleged here, are appropriate considerations to relieve a party of what it feels

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[9] *United Gas Pipe Line Co.* v. *Mobile Gas Corp.*, 350 U.S. 332; *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956). In *Mobile*, the Court held that a pipeline which had entered into a fixed rate, fixed term contract to sell natural gas could not unilaterally change its rates by making a filing pursuant to section 4 of the Natural Gas Act. In *Sierra*, the Court applied its holding to public utilities acting under section 205 of the Federal Power Act. In addition, the Court stated that the sole concern of the Commission in determining whether a public utility could be relieved of an improvident bargain pursuant to section 206 of the Federal Power Act would seem to be whether the fixed rate is "so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excess burden, or be unduly discriminatory." 350 U.S. at 355.

is an unfavorable contractual bargain in a section 206 proceeding. With respect to GSU's *Mobile-Sierra* financial hardship argument, we need not decide, in this case, whether it is appropriately raised by a purchaser which seeks to be relieved of its contractual obligations, rather than by a seller. Whatever the parameters of the *Mobile-Sierra* standard, we find, as stated below, that GSU has not demonstrated that the contracts with the Southern Companies should be modified on account of financial considerations.

Burdens and Benefits Under the Contract

GSU and SRG&T contend that the contracts at issue are not producing the benefits to the former which were originally anticipated and alluded to in the UPS agreement. Specifically, they claim that GSU can produce energy more cheaply from its own generation than by continuing the purchases from the Southern Companies. GSU also argues that it is suffering losses under the contracts while the Southern Companies are reaping benefits in excess of their cost of service.

The presiding judge determined that the language in the UPS agreement was prefatory in nature, not guaranteeing that GSU would realize benefits over the life of the agreements. The presiding judge found, nonetheless, that a number of benefits to GSU remain, including: deferral of construction or acquisition of new capacity; lower costs of capacity and energy under the contracts than originally forecast, and as compared to alternative sources of capacity and energy; diversity of fuel mix; maximizing utilization of low cost natural gas; and establishing an interconnection with the Southern Companies, providing a transmission path in addition to that provided by GSU's link to the Middle South Utilities, Inc. System. He also found that GSU had improperly compared GSU's avoided energy costs alone to the cost of capacity and energy from the Southern Companies: a proper comparison would be between the cost of capacity and energy costs which would have been incurred by GSU had it built 1,000 MW of coal-fired capacity

and the capacity and energy costs associated with the purchase from the Southern Companies.

As to GSU's allegation that it has suffered a financial loss while the Southern Companies have reaped a windfall, this was based upon a benefits/burdens analysis prepared for GSU by witness Mozer (Exhs. G-91 and G-94). The presiding judge found that Commission precedent[10] did not sanction a comparative evaluation of the relative benefits and burdens accruing to the contracting parties, and that, in any event, witness Mozer's analysis was entitled to little weight due to a number of flaws in it. Correcting the analysis in various respects, the judge found that the UPS agreement benefits both parties throughout the term of the contract. As a result, he found GSU's claims regarding the expected benefits and burdens to be without merit, and that they did not support the utility's claim for relief under section 206(a) of the FPA.

On exception, GSU contends that the presiding judge erred in failing to find that the UPS agreement and Schedule E establish mutual benefits and efficiencies as the basis of the agreement, and that the agreements do provide for adjustment in light of changed circumstances. GSU Brief on Exceptions, pp. 46-57. GSU also contends that he erred in failing to find that the benefits and burdens under the parties' contracts are grossly mismatched, and that such disparity is unjust and unreasonable. The utility reiterates that it is suffering "losses" under the agreements while the Southern Companies are reaping benefits in excess of their costs.

We agree with the initial decision's determination that GSU's benefits/burdens claims are without merit and do not support its claim for relief under section 206(a). As to the claim that the parties' contracts are to be adjusted in order to restore the balance of mutual benefits, the presiding judge correctly found that the references to mutual benefits cited by GSU are merely

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[10] *Pennsylvania Power and Light Company*, 23 FERC ¶ 61,325 (1983).

prefatory in nature. Nor do any other provisions in the UPS agreement or Schedule E require that the contracts be reformed in the circumstances of this case. Section 2.2.1 of the UPS agreement, upon which GSU principally relies, does not compel or require the parties to agree to changes in the utility's purchase obligation; the utility concedes this on brief. GSU Brief on Exceptions, p. 53.

Independent of the parties' contractual obligations, we do not find the contracts at issue to be unjust, unreasonable, unduly discriminatory or preferential, or otherwise contrary to the public interest on account of an alleged lack of benefits or mismatch between benefits and burdens.

The Commission has previously indicated that the considerations which GSU raises are not germane to an assessment of the contracts' justness and reasonableness. In *Philadelphia Electric Co.*, 15 FERC ¶61,264 (1981), the Commission accepted an agreement for the sale of nuclear capacity and energy by Philadelphia Electric Company to Jersey Central Power & Light Company over the objections of a state consumer advocate who claimed, among other things, that the sale would result in the seller having to purchase high cost oil-fired generation to replace the nuclear energy, if energy were needed, during the term of the agreement. In rejecting the claim that, as a result, the contract was unjust and unreasonable, the Commission stated:

> . . .our decision to accept the contract rate and service agreement is not predicated on a determination that, over the initial term of a contract, PE could have done no better selling to someone else, or that Jersey Central could have done no better buying from someone else, or that the transaction will redound to the benefit of the retail and wholesale requirements customers of the two respective parties to the contract. It does appear that PE's other customers will realize a net benefit over the initial term of the contract; but we do not mean by this order to prejudge, for our own purposes or those of the respective state commissions, a determination of the prudence of either party in entering into this transaction.

15 FERC at p. 61,601.

More recently, in *Pennsylvania Power and Light Co.*, 23 FERC ¶ 61,325 (1983), the Commission denied a request to find a contract unjust and unreasonable on the ground that the purchaser did not need the power and that the purchase was uneconomic. In that order, the Commission set forth its views concerning its role under the Federal Power Act. The Commission stated, in relevant part:

> The legislative purpose of the Federal Power Act is to ensure that the rates and terms of service for transmission and sales of electric energy subject to the jurisdiction of the Commission are just and reasonable. We have made that public interest determination here by finding that PP&L's rates under the agreement are not excessive.
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> * * * *
>
> . . . We do not view our responsibilities as including a determination that the purchaser has purchased wisely or has made the best deal available. However, these are legitimate concerns of the State commissions and this Commission in determining whether purchases reflect prudently incurred expenses for purposes of determining the purchaser's rates for sales to others.

23 FERC at p. 61,716.[11]

These considerations are equally applicable to GSU's position in this case. Capacity and energy sold under the UPS agreement and Schedule E are priced pursuant to cost-of-

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[11] *See also Southern Company Services, Inc.*, 26 FERC ¶ 61,360 (1984). Where the purchaser is a member of an integrated public utility holding company system, state review of the purchaser's prudence in entering into a particular wholesale power arrangement with the other members of the system is preempted by federal law. *Appalachian Power Co.* v. *Public Service Commission of West Virginia*, 812 F.2d 898 (4th Cir. 1987); *AEP Generating Co.*, Opinion No. 266, 38 FERC ¶ 61,243, *reh'g denied*, Opinion No. 266-A, 39 FERC ¶ 61,158 (1987); *American Electric Power Service Corp.*, 32 FERC ¶ 61,363 (1985), *reh'g denied*, 37 FERC ¶ 61,001 (1986).

service formula rates. The presiding judge found that the formula rate in the UPS agreement is just and reasonable, and we have affirmed that determination. GSU witness Murrill, on cross-examination, conceded that the Southern Companies are not recovering more than their costs, including a reasonable return on investment. Tr. 1237, 1239. In alleging that the UPS agreement and Schedule E are not producing the benefits expected, or that the burdens and benefits are widely disparate, GSU has done no more than establish that the agreements with the Southern Companies may be uneconomic to it at this time.[12] This does not render them unjust and unreasonable or contrary to the public interest under the FPA.

Assuming *arguendo* that GSU's burdens/benefits arguments are appropriately considered, GSU has failed to establish that it is suffering "losses" under the contract, while the Southern Companies are reaping "benefits" in excess of their costs. What GSU characterizes as "losses" are the capacity and energy payments which it is obligated to make under the contract, offset by energy savings through May 31, 1987. GSU Brief on Exceptions, p. 70; Exhs. G-91, p. 24; G-94. Payment of amounts which one is contractually obligated to make does not constitute a "loss." As to the other half of GSU's claim, *viz*, that the Southern Companies are reaping benefits in excess of their costs, we have already determined (and GSU witness Murrill conceded) that this is not the case.

GSU's burdens/benefits claims are based, in part, upon an analysis prepared by witness Mozer. Witness Mozer conceded, however, that his study did not quantify all of the benefits which flow to GSU under the contracts. Tr. 684. The witness also conceded that his study erred in that it assumed GSU had actually paid amounts owing to the Southern Companies under the contracts, and that the results produced by his study

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[12] We express no view as to whether GSU's decision to purchase capacity and energy from the Southern Companies was prudent. The question was not at issue in this proceeding.

should be altered as a result. Tr. 658-660, 662. The witness' conclusions as to what constituted benefits to GSU under the contracts were contradicted by company officials. Tr. 666-675, 701-712. Exhs. S-85; S-103.[13] We agree with the presiding judge that, in the circumstances, little weight can be given the study prepared by witness Mozer.

GSU's Financial Situation

One of the major considerations upon which GSU relies in support of its claim for relief is the utility's weakened financial condition. The company claimed that it had no cash earnings in 1986 and faced a cash deficit of over $400 million in 1987, exclusive of capacity payments due to the Southern Companies; had reduced or omitted the dividends on its common and preferred stock; had its bond ratings lowered; and had other lines of available credit reduced. Exh. G-55.

The presiding judge, after evaluating the evidence, concluded that GSU's current financial difficulties arise principally as a result of difficulties encountered in obtaining retail rate relief associated with the utility's River Bend Nuclear Plant. Any modification of the UPS agreement or Schedule E would not relieve GSU's cash flow problems since the company is not making any payments to the Southern Companies for capacity under those agreements. The judge also found that no showing had been made that Commission action with respect to the contracts would insure the continuation of reliable service under the circumstances presented. As a result, the presiding judge concluded that GSU's evidence of financial hardship did not support its claim that the contracts at issue were unjust, unreasonable, unduly discriminatory or preferential, or contrary to the public interest. 39 FERC at p. 65,155.

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[13] In so stating, we do not purport to determine the specific benefits which flow to GSU under the contracts at issue or rule whether the presiding judge was correct in his determination of the benefits. Rather, we cite to the other witnesses' statements simply for creditability purposes.

GSU excepts to the initial decision. While conceding that state regulatory treatment of the River Bend Nuclear Plant has caused problems, the utility argues that the contracts with the Southern Companies are also a significant contributing factor to its "precarious" financial position, and that it is unlikely to recover its financial health without relief from the contracts. GSU takes issue with the judge's determination as to the effect of contract modification upon its ability to continue service, alleging that it need not prove that the contracts at issue are the sole, direct, and proximate cause of its difficulties. GSU objects to the judge's failure to consider matters other than the utility's cash flow. Lastly, the utility contends that the judge erred in accepting the Southern Companies' arguments as to the rate moderation plan submitted by GSU to the Texas and Louisiana Commissions.

At the outset, we are not convinced that GSU's arguments that financial hardship, even if substantiated by the evidence, would justify relief under section 206(a) of the FPA from its contracts with the Southern Companies under the circumstances present in this case. As we have indicated elsewhere in this opinion, the question of whether a contract is financially burdensome to the purchaser is distinct from whether the contract is just and reasonable. *Pennsylvania Power and Light Co., supra*. In any event, we are not persuaded by the evidence that relief would be warranted in this case for the reasons advanced by GSU in this proceeding, even if financial hardship were a proper basis for relief.

As the presiding judge found, the primary cause of GSU's financial difficulties relate to the utility's problems with the River Bend Nuclear Station and recovery of costs associated with that plant in its retail rates.[14] GSU does not deny this, but argues that the contracts with the Southern Companies add to its difficulties, and that relief from these agreements is necessary. However, as the presiding judge correctly noted, GSU is

[14] *See, e.g.*, Tr. 235, 442-447.

not currently making payments for capacity due to the Southern Companies. The contracts therefore are not contributing to the company's current cash flow problems. Rate proposals submitted by GSU to the Texas and Louisiana Commissions for retail rate relief (i.e., GSU's "rate moderation plan") indicate that, if they were adopted, the company would generate a positive cash flow after 1987, even if it does not recover retail revenues associated with the capacity payments due the Southern Companies. Exh. 58, pp. 2-6; Exh. 59.[15]

In addition to cash flow considerations, GSU contends that the continuation of its obligations to the Southern Companies threatens its ability to obtain needed financing. On cross-examination, however, GSU witness Donnelly, the utility's chief financial officer, was unable to offer any evidence in support of this allegation; he was unable, for example, to cite any communication from creditors, banks, or other possible lenders to the effect that the GSU-Southern Companies contracts were the reason for refusing to provide loans to the utility. Tr. 374.

GSU further contends that the presiding judge was overly optimistic about the company's obtaining adequate retail rate relief under its rate moderation plan, and that he focused too heavily on the results which would occur in 1990, rather than upon the years 1987-1989.

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[15] GSU also objects to the judge's apparent requirement that the contracts with the Southern Companies be the "sole, direct, and proximate" cause of its difficulties. We note that in resolving whether to relieve a seller of a fixed rate, fixed term obligation, the Commission has required the utility to show pernicious adverse effects on the public which it serves which are directly and substantially attributable to the rate at issue, and that relief must be capable of affording some significant protection from the injury found to have been imposed. *Philadelphia Electric Co.*, Opinion No. 791, 58 FPC 88, 101 (1977). GSU does not offer any valid reason for concluding that a less strict standard should apply to it, in the event financial hardship is to be considered proper grounds for relieving a purchaser of its obligation.

It appears from the initial decision that the presiding judge did not make any findings regarding the rate moderation plan but simply repeated the Southern Companies' position that the plan would provide GSU with adequate relief. We do not believe that it is appropriate for this Commission to speculate as to the adequacy of retail rate relief awarded GSU by the state commissions. At the same time, the exercise of our exclusive jurisdiction over wholesale arrangements should not, in our view, be controlled by decisions made by state regulatory authorities exercising their proper authority over a utility's retail rates.

We conclude that the presiding judge properly rejected GSU's claim for relief on account of financial hardship.

Reliance by the Southern Companies

GSU and its supporters raised at hearing the issue of whether the Southern Companies relied upon the UPS agreement in deciding to continue the construction of generating units dedicated to GSU under that agreement. The presiding judge found that the question of reliance was irrelevant in assessing whether the UPS agreement or Schedule E are unjust, unreasonable, unduly discriminatory or preferential, or contrary to the public interest. Nonetheless, he went on to find that the Southern Companies did rely upon the UPS agreement in deciding to continue their construction program.

SRG&T and the Louisiana Commission except. They again contend that the Southern Companies did not rely upon the UPS agreement in continuing their construction program. Recovery by the Southern Companies of the capacity's costs from GSU, SRG&T argues, violates the principle that cost burdens should follow cost causation. SRG&T further argues that the contracts at issue were executed in order to displace GSU's gas-fired generation. Since the utility does not presently need the capacity provided by the agreements and can generate energy more cheaply from its own resources, the contracts are unjust and unreasonable.

In our view, GSU's contracts with the Southern Companies are not unjust and unreasonable or contrary to the public interest due to any alleged lack of reliance. Regardless of whether the Southern Companies would have built the units absent their agreement with GSU, they have fulfilled their obligation to make certain capacity available to GSU, have incurred costs in doing so, and their charges are based upon those costs. GSU is entitled to treat the capacity and energy available to it under the UPS agreement as part of its own system's. Tr. 104, 106-7. The recovery by the Southern Companies of the costs associated with those output from those units is not, in the circumstances, unjust and unreasonable or contrary to the public interest.

We reject the claim by SRG&T that recovery of costs from GSU does not match cost burdens and cost incurrence. The UPS agreement provides that GSU pay only for the capacity and energy made available under the agreement to it. As to SRG&T's argument that the contract is presently unjust and unreasonable because the purpose for which GSU entered into the contract has not been realized, the utility's subjective intent is irrelevant to assessing the rates, terms, and conditions of the UPS agreement.

The Southern Companies' Need For Capacity

Another non-cost factor raised by GSU in support of its complaint was the consideration of whether the Southern Companies would need the capacity provided to GSU under the UPS agreement. The presiding judge held that the issue was moot in light of his determination that the utility was not entitled to relief. Nevertheless, he went on to find that the Southern Companies' load forecasts were lower than originally forecast and, therefore, the evidence did not indicate that they would need the unit power during the term of the UPS agreement.

On exception, GSU states that the presiding judge's finding misses the thrust of its argument, that is, that the Southern

Companies are far more likely to be able to make efficient use of the unit power capacity because their projected reserves are near target levels while GSU's reserves are well in excess of its target level of 18%. The utility states that while this factor alone would not justify modification of the contracts, it does support the view that the contracts no longer make sense in their present form. GSU Brief on Exceptions, p. 83.

GSU's evidence on this issue was submitted by witness Lanou, who testified that, based upon recent experience, the Southern Companies' load forecast for the period 1987-1992 *may* tend to underestimate future system peak. Exh. G-82, p. 19 (emphasis added). We believe that the speculative nature of the witness' conclusion fails to establish that the Southern Companies are more likely to need the UPS agreement capacity. In any event, GSU has failed to demonstrate how this factor renders the UPS agreement or Schedule E unjust, unreasonable, unduly discriminatory or preferential, or contrary to the public interest under the Federal Power Act.

Lack of Efficiency

GSU contends that its contracts with the Southern Companies promote inefficiency and waste of resources because it can generate energy more cheaply from its own resources. The company alleges that the presiding judge erred in failing to find that the contracts are therefore unjust and unreasonable. GSU cites to other Commission precedent in which contracts which allegedly foreclosed purchasers' options were declared unjust and unreasonable, particularly Order No. 380.[16] GSU Brief on Exceptions, pp. 81-82.

Assuming arguendo that GSU is correct in asserting that it can generate energy more cheaply from its own resources, we

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[16] Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions, 48 Fed. Reg. 22,778 (1984) [*FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,571].

are sympathetic to the concern that the contracts with the Southern Companies may not result at the present time in the optimal allocation and use of energy resources. Nonetheless, this concern does not lead us to conclude that relief under section 206(a) of the FPA is warranted in this case. The inefficiency of which GSU complains does not arise from any particular provision in its contracts. Those contracts recover no more than the Southern Companies' cost of service. Rather, the diminished efficiency arises from changes in external circumstances (i.e., declines in natural gas prices, lower than expected growth in demand) over which neither party had control. In addition, we must bear in mind that the Federal Power Act recognizes the value of preserving contract stability in the electric utility industry. *See United Gas Pipe Line Co.* v. *Mobile Gas Corp.*, 350 U.S. 332, 338 and 344 (1956); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956). The inefficiency of which GSU complains may be eliminated in the future, in the event conditions change again. The presiding judge, in essence, recognized this, in the context of discussing GSU's burdens/benefits arguments, when he stated that there had been no showing that the benefits from the contracts would not continue in the future or even increase if natural gas prices escalated. 39 FERC at p. 65,150. We believe that, in this case, concerns about inefficient allocation of resources are outweighed by the goal of promoting contract stability and the other considerations articulated in this Opinion.

Order No. 380, cited by GSU, does not support its claim for relief. In Order No. 380, the Commission determined that the recovery of variable costs by natural gas pipelines in minimum bill provisions was unjust and unreasonable under the Natural Gas Act. The Commission found that such provisions gave pipelines the opportunity to recover "costs" which had not, in fact, been incurred in providing service to customers. In addition, the Commission found that minimum bill provisions were anticompetitive in effect and, thus, prevented the efficient workings of natural gas markets. The concerns regarding over-

recovery of costs and competition which gave rise to Order No. 380 are not present in this case, however.[17]

2. The Southern Companies' Petition For a Declaratory Order

In addition to the issue of whether the UPS agreement or Schedule E should be modified, we set various matters of contract interpretation for hearing. We did so because it appeared, at the time of the hearing order, that these matters touched upon the reasonableness of the rates under the agreements at issue. 37 FERC at p. 61,652. However, on the basis of a fully-developed evidentiary record the parties' briefs, it now appears that a number of contract interpretation issues do not touch upon the reasonableness of the parties' rates. They do not appear to necessitate an exercise of the Commission's technical

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[17] GSU also cites *Chattanooga Gas Co.* v. *East Tennessee Natural Gas Co.*, Opinion No. 494, 35 FPC 902, *clarified*, Opinion No. 494-A, 36 FPC 325 (1966) in support of its argument that its capacity purchase obligation may be modified to promote more efficient use of resources. In Chattanooga, the Commission declared a 40,000 Mcf/day contract demand provision in a distributor's contract with a pipeline to be unjust and unreasonable and modified to provide for a 32,000 Mcf/day figure, which approximated the distributor's actual take. The Commission's action was predicated upon various factors, including: (1) the distributor did not take gas at the contracted-for level; (2) the pipeline was unable to deliver the contracted-for amount; (3) the 40,000 Mcf/day figure had no revenue or cost significance to the pipeline; and (4) the Commission had not approved the amount pursuant to its certification authority under section 7 of the Natural Gas Act, 15 U.S.C. § 717f (1982). We also note that the case was later settled by the parties. 36 FPC 841 (1966). In this case, the Southern Companies have built capacity to meet their obligations, and modification of the contract would affect their revenues. In addition, the Commission does not have certification authority over electric service analogous to its section 7 authority under the Natural Gas Act. Thus, *Chattanooga* is inapposite to this case.

expertise or otherwise raise concerns central to our regulatory responsibilities under the Federal Power Act. Finally, GSU has dropped various allegations set forth in its complaint which would have necessitated interpretation of the parties' contracts. Therefore, with respect to the following matters of contract interpretation, we find it unnecessary to pass upon the initial decision's determinations: issues 7, 8, 9, 10, 11, 17, 20, 21, and 23. These matters concern the Southern Companies' "long-term power" obligations under Schedule E, and the meaning of the contract's "*force majeure*" and bill dispute provisions.

Issues 12, 13, 14, 15, 16, 18, and 19 concern the effect of state commission decisions on GSU's obligations. The presiding judge ruled that: state regulatory treatment does not alter, affect, relieve, excuse, suspend, or discharge GSU's contractual obligations; GSU is not prevented by a denial of full recovery of costs incurred under the UPS agreement in retail rates from performing its contractual obligations; the orders of the Texas and Louisiana Commissions do not mandate a breach by GSU of its obligations; and favorable state regulatory treatment of the costs incurred under the UPS agreement of Schedule E are neither conditions precedent nor subsequent of those agreements. 39 FERC at p. 65,163. We affirm the presiding judge's determinations.

GSU, while arguing that the effect of state regulatory decisions is relevant to our determination of the utility's complaint, requests that the Commission not address the effect of those decisions on the state claims currently pending in federal court, such as whether performance by GSU under the agreements is "impossible" or "commercially impracticable."

With respect to GSU's claim that the effect of unfavorable state regulatory decisions is relevant to its section 206(a) claim, we have already addressed and rejected that contention. With respect to GSU's state law claims such as "impossibility" or "commercial impracticability," we do not understand the initial decision to have resolved them, nor do we purport to do so.

Rather, the presiding judge simply undertook to interpret the meaning of the parties' contracts.[18]

Sections 2.2.1 and 2.2.4

The principal contract dispute between GSU and the Southern Companies concerns the meaning of sections 2.2.1 and 2.2.4 and the effect of the latter upon the former. (Issues 3, 4, 5, and 6 in the initial decision).

The initial decision found that: (1) section 2.2.1 imposes an obligation upon the parties to negotiate in good faith and with due diligence any future increases or decreases in capacity under the UPS agreement; (2) this obligation is enforceable by a court, and an appropriate remedy may be fashioned in the event of breach. The decision stated, however, that section 2.2.1 does not compel the parties to agree or proceed upon a particular alternative; (3) the Southern Companies had negotiated in good faith; (4) the addition of section 2.2.4 in 1983 does not limit the operation of section 2.2.1, but merely prescribes a formula which automatically adjusts the mix of capacity between the UPS agreement and Schedule E; (5) section 2.2.1 does not provide a contractual basis pursuant to which GSU may be relieved by the Commission of its contractual obligation; and (6) section 2.2.1 of the UPS agreement does not apply to Schedule E, and the latter agreement does not contain a provision comparable to section 2.2.1. 39 FERC at pp. 65,157-59.

The Southern Companies state that they do not except to the presiding judge's ruling that section 2.2.1 neither compels the parties to agree nor requires them to proceed under a particular alternative, or to his determination that they have nego-

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[18] Although we do not purport to resolve GSU's pending state law claims, several of those claims may, as the Fifth Circuit noted, be preempted by the Federal Power Act. *Gulf States Utilities Co.* v. *Alabama Power Co.*, 824 F.2d 1465, 1471, n.6, *opinion modified and rehearing en banc denied*, 831 F.2d 557 (1987).

tiated in good faith.[19] However, they except to the rulings that section 2.2.1 is enforceable by a court, and that an appropriate remedy may be fashioned by a court in the event of breach. The Southern Companies characterize section 2.2.1 as a mere agreement to negotiate and, thus, too vague to be enforced by a court. In addition, they allege that remedial action by a court in the event of breach violates the "filed rate" doctrine. Southern Companies' Brief on Exceptions, pp. 15-22.

In the event that the Commission affirms the initial decision's ruling that section 2.2.1 is enforceable, the Southern Companies state that we must determine whether section 2.2.4 modifies the parties' obligations under section 2.2.1. With respect to this matter, the Southern Companies allege that section 2.2.4 evidences an intent that further declines in natural gas prices and greater availability of gas would not be a basis upon which to request negotiations pursuant to section 2.2.1; they do *not* argue that the addition of section 2.2.4 eliminates their section 2.2.1 obligations *in toto*, or that section 2.2.4 restricts the parties' ability to mutually agree upon a new arrangement if they so choose. In support, the Southern Companies claim that the agreement in 1983 to substitute Schedule E capacity for UPS agreement capacity cost them $350-400 million in foregone payments. The limitation of the Southern Companies' obligation to negotiate increases or decreases in capacity due to falling gas prices in the future is alleged to be the *quid pro quo* for the 1983 concessions. In addition, the Southern Companies point to the language of section 2.2.4 which states that "the amount of unit power capacity . . . is subject to being increased (but in no event decreased) . . . ." Southern Companies' Brief on Exceptions, pp. 22-29.

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[19] Although no participant excepts, we specifically decline to adopt the presiding judge's ruling on the question of whether the Southern Companies have negotiated in good faith. In our hearing order, we expressly stated that we would not resolve this issue, 37 FERC at p. 61,652, and we find no reason at this stage of the proceeding to alter our conclusion.

Staff also contends that the addition of section 2.2.4 limits the Southern Companies' obligation under section 2.2.1. Staff Brief on Exceptions, pp. 4-8. Staff contends, however, that section 2.2.1 is a valid enforceable provision. Staff Brief Opposing Exceptions, pp. 58-62.

GSU opposes the Southern Companies' and Staff's exceptions. It contends that section 2.2.1 is enforceable, and that the parties' section 2.2.1 rights are unaffected by section 2.2.4. In support, GSU argues that while the Southern Companies attempted to delete section 2.2.1 during the 1983 negotiations, they were unsuccessful. Further, GSU states that the parties would have clearly stated that section 2.2.4 limits the scope of 2.2.1 had such a result been intended. GSU disputes the Southern Companies' characterization of the 1983 amendment as a "concession," alleging that this Commission would have disapproved the agreement as filed due to the opposition at the time of the Louisiana Commission. Lastly, GSU contends that the Southern Companies' argument that section 2.2.4 limits section 2.2.1 is inconsistent with the claim that the latter is unenforceable. According to GSU, "[i]t seems extremely implausible that Southern would have paid significant value to restrict an obligation that it believed could never be enforced." GSU Brief Opposing Exceptions, pp. 8-12.

We affirm the presiding judge's rulings that: section 2.2.1 does not compel the parties to agree upon or proceed under a particular alternative; that section 2.2.1 does not provide a contractual basis upon which we may relieve GSU of its obligations; that section 2.2.1 does not apply to Schedule E; and that Schedule E does not contain a provision in it comparable to section 2.2.1 of the UPS agreement.

We find it unnecessary to determine whether section 2.2.1 is an enforceable provision for which a court could fashion a remedy in the event of breach. Assuming *arguendo* that it is enforceable, the provision does not, as the presiding judge found, compel the parties to agree to changes in GSU's capacity purchase obligation. We also need not determine whether sec-

tion 2.2.4 limits GSU's rights under section 2.2.1 of the UPS agreement. Again, assuming that GSU's section 2.2.1 rights are unaffected by section 2.2.4, the former does not compel the parties to agree to changes in capacity.

Motion to Lodge

On September 8, 1987, GSU filed a motion to lodge a copy of the Fifth Circuit's decision in *Gulf States Utilities Co. v. Alabama Power Co.*, 824 F.2d 1465 (5th Cir. 1987). GSU argues that the court's decision affirms our determination that we need not assume jurisdiction over most of its state law claims or decide such issues in exercising our jurisdiction under section 206 of the FPA.

The Southern Companies moved for leave to file a late answer to GSU's motion.[20] They opposed the motion as premature, since they were seeking rehearing *en banc* of the panel's decision. Thus, the decision was not, at that time, final.[21] In the event that GSU's motion were granted, the Southern Companies requested permission to file a response on the merits after the court's decision.

We shall grant the Southern Companies' motion for leave to file a late answer. We shall also grant GSU's motion to lodge, because it calls to our attention a decision in a case related to this proceeding. The court's decision is, of course, not binding upon or dispositive of the issues before the Commission. We shall deny the Southern Companies' request for leave to file a response on the merits. In light of the purpose for which we are granting GSU's motion to lodge, we find that further argument by the Southern Companies is unnecessary.

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[20] As good cause for its untimely filing, the Southern Companies stated that they were occupied preparing the petition for rehearing *en banc* at the time GSU filed its motion.

[21] As indicated, rehearing *en banc* was previously denied. *See* 831 F.2d 557 (1987).

Motion to Reopen The Record

On March 15, 1988, GSU filed a motion to reopen the record to receive evidence concerning recent state commission decisions and their effect on the utility's financial condition. GSU argues that these developments support its claim that the contracts with the Southern Companies are unjust, unreasonable, unduly discriminatory or preferential, and contrary to the public interest, and that the presiding judge erred in concluding otherwise. The utility has not submitted the evidence along with its motion. Timely answers to GSU's motion were filed by SRG&T, which supports it, and by the Southern Companies and Staff, which oppose it. An untimely answer in support of the motion was filed by the Louisiana Commission.[22]

The question of whether to reopen the evidentiary record is a matter of agency discretion. Administrative agencies have been required by courts to reopen the record only in cases of "extraordinary circumstances." *Bowman Transportation, Inc.* v. *Arkansas Best Freight System, Inc.*, 419 U.S. 281, 296 (1974). "Extraordinary circumstances," in turn, have been defined as a change in circumstances "that is not merely 'material' but rises to the level of a change in 'core' circumstances, the kind of change that goes to the very heart of the case." *American Financial Services Ass'n* v. *FTC*, 767 F.2d 957, 964, n.5 (D.C. Cir. 1985); *American Optometric Ass'n* v. *FTC*, 626 F.2d 896, 907 (D.C. Cir. 1980); *see also, Greater Boston Television Corp.* v. *FCC*, 463 F.2d 268, 283 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 950 (1972). The policy against reopening the record except in extraordinary circumstances rests upon the need to bring finality, at some point, to the administrative process. *ICC* v. *Jersey City*, 322 U.S. 503, 514 (1944).

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[22] As good cause for its late-filed answer, the Louisiana Commission states that it did not receive notice of the Commission's March 17 order shortening the period for answers to March 23 until the day after answers were due. In view of the lack of prejudice to other parties, we shall accept the Louisiana Commission's answer for filing.

In this case, GSU has already presented evidence and arguments as to its financial condition, state commission decisions, and the relevance of those considerations to the question of whether the agreements with the Southern Companies should be modified. As stated elsewhere in this opinion, we do not find that the utility's claims on these issues justifies modification of its agreements. Based on the arguments contained in its pleadings, we do not find that GSU has demonstrated a change in core circumstances. We shall therefore deny its motion to reopen the record.

The Commission orders:

(A) GSU's motion to lodge a copy of the decision in *Gulf States Utilities Co.* v. *Alabama Power Co.* is hereby granted.

(B) The Southern Companies' motion for leave to file a late-filed answer to GSU's motion to lodge is hereby granted as indicated in the body of this opinion.

(C) The Louisiana Commission's late-filed answer in support of GSU's motion to reopen the record is hereby accepted for filing.

(D) GSU's motion to reopen the record is hereby denied.

(E) The initial decision issued on May 12, 1987, is, to the extent indicated in this opinion, hereby affirmed.

(F) GSU's complaint for relief under section 206(a) of the Federal Power Act from its obligations under the UPS agreement and Schedule E of the Interchange Contract is hereby dismissed.

(G) The Southern Companies' petition for a declaratory order is granted as indicated in the body of this opinion.

(H) Docket Nos. EL86-53-001 and EL86-57-001 are hereby terminated.

[¶ 61,394]

Southern Company Services, Inc., Docket No. EL86-53-003;

Gulf States Utilities Company v. Southern Company Services, Inc. et al., Docket No. EL86-57-003

Opinion No. 300-A; Order Denying Rehearing and Terminating Dockets

(Issued June 1, 1988)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon and Charles A. Trabandt.

[Note: Opinion No. 300 affirming Initial Decision in part, dismissing complaint, and terminating dockets issued April 1, 1988, appears at 43 FERC ¶ 61,003.]

[Opinion No. 300-A Text]

On May 2, 1988, Gulf States Utilities Company (GSU) and Sam Rayburn G & T Electric Cooperative, Inc. (SRG&T or Sam Rayburn) filed requests for rehearing of Opinion No. 300, issued in this proceeding on April 1, 1988, 43 FERC ¶ 61,003. In that Opinion, the Commission denied GSU's request for relief, pursuant to section 206(a)[1] of the Federal Power Act, from its obligation to purchase capacity and energy from the operating utilities of The Southern Company system (Southern Companies). The Commission also denied, in the Opinion, a request by GSU filed on March 15, 1988, to reopen the evidentiary record in this proceeding.

In support of its request for rehearing, GSU alleges fifty specific points of error in the Commission's Opinion. Broadly, the utility argues that: (1) the Commission is empowered to modify its purchase obligation; (2) the parties' contracts

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[1] 16 U.S.C. § 824e(a) (1982).

expressly provide for modification of GSU's purchase obligation in light of changed circumstances; (3) the Commission erred in concluding that the cost-of-service formula rate in the UPS agreement has not become unjust, unreasonable, or discriminatory; (4) the Commission erred in rejecting the utility's arguments concerning efficiency, the relative impact of the contracts upon the parties, and reliance by the Southern Companies on continuing their construction plans; (5) the contracts are grossly disproportionate in their burdens and benefits; and (6) continuation of the contracts with the Southern Companies threatens the company's solvency. GSU has included, along with its request for rehearing, updated cash flow projections which reflect the most recent retail rate decisions of the Texas and Louisiana Public Service Commissions and recent filings submitted to the Securities and Exchange Commission. The utility also cites this material in support of its request for rehearing of our decision denying its motion to reopen the evidentiary record.

SRG&T argues that: (1) it is unjust, unreasonable, unduly discriminatory, and not in the public interest to hold GSU to its purchase obligation given that the utility does not need the capacity, can generate energy more cheaply from its own system, and the company is in weak financial condition; (2) the Commission erred in failing to modify the parties' contracts on the ground that they misallocate resources and promote inefficiency; and (3) the Commission erred in refusing to weigh the buyer's interests in assessing the contracts. Sam Rayburn also summarily objects to the other points made by the Commission in Opinion No. 300 in denying GSU's section 206(a) claim.

Discussion

We have carefully considered the arguments set forth in GSU's and SRG&T's requests for rehearing. Based upon the pleadings, we find no reason to grant rehearing of our decision in Opinion No. 300. We also find that additional discussion is not warranted, except for one matter.

GSU notes that we indicated, in Opinion No. 300, that the utility had not submitted any evidence along with its motion to reopen the record. It has now submitted material which allegedly justifies its motion, as well as the claim that its obligation to purchase capacity and energy from the Southern Companies should be modified on account of the company's weakened financial condition.[2]

Although we did allude to GSU's failure to submit supporting evidence along with its motion, this was not the basis for our decision to deny the motion to reopen the record. Our decision was based upon our determination that the utility's claims with respect to its financial condition and state commission decisions did not justify abrogating or modifying GSU's obligation to purchase capacity and energy from the Southern Companies. 43 FERC at 61,024. Based upon the material which GSU has submitted along with its request for rehearing, we adhere to our prior conclusion that the utility's financial difficulties arise primarily as a result of problems with the River Bend Nuclear Generating Station and recovery of costs associated with that plant in retail rates, and, therefore, these considerations do not justify altering GSU's agreements with the Southern Companies. GSU has not demonstrated "extraordinary circumstances" which would warrant reopening the evidentiary record. We find no reason to grant rehearing of Opinion No. 300, either insofar as we denied the utility's motion to reopen the record or in any other respect, in light of the material accompanying GSU's request for rehearing.

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[2] On May 10, 1988, the Southern Companies filed a motion to strike the attachments to GSU's request for rehearing on the ground that GSU is improperly seeking to inject information which we declined to receive when we originally denied its motion to reopen the record. We shall deny the Southern Companies' motion to strike. GSU is simply exercising its right to seek rehearing of our prior ruling. Moreover, in light of our substantive disposition of the request for rehearing, the Southern Companies have not been prejudiced by the inclusion of the attachments.

The Commission orders:

(A) The Southern Companies' motion to strike is hereby denied.

(B) The requests of GSU and SRG&T for rehearing of Opinion No. 300 are hereby denied.

(C) Docket Nos. EL86-53-003 and EL86-57-003 are hereby terminated.

[¶ 63,026]

Southern Company Services, Inc., Docket No. EL86-53-001;

***Gulf States Utilities Company* v. *Southern Company Services, Inc., et al.*, Docket No. EL86-57-001**

Presiding Administrative Law Judge's Initial Decision on Petition for Declaratory Order and on Complaint

(Issued May 12, 1987)

Michel Levant, Presiding Administrative Law Judge.

Appearances

William Warfield Ross, William L. Powers and *Shira K. Modell, Tom F. Phillips, Frederick Tulley, Cecil Johnson, Paul W. Gertz*, and *Jane Seigler* on behalf of the Gulf States Utilities Company

Rodney O. Mundy, Charles M. Crook, James H. Miller and *Dan H. McCrary* on behalf of Southern Company Services, Inc., and the Alabama Power Company

Robert H. Forry on behalf of Georgia Power Company

Ben H. Stone on behalf of Mississippi Power Company

William D. DeGrandis and *N. Reth Emery* on behalf of the Oglethorpe Power Corporation

Frank J. Uddo, Ted Jones and *Elizabeth Porter* on behalf of Louisiana Public Service Commission

Frederick H. Ritts and *Garrett Stone* on behalf of Sam Rayburn G &T, Inc.

Robert A. O'Neil and *Mary A. Hekman-Lielbriedis* on behalf of Brazos Electric Power Cooperative

G. Edison Holland, Jr. on behalf of Gulf Power Company

William A. Chesnutt on behalf of Gulf States Energy Users Group

Wallace E. Brand on behalf of Louisiana Towns of Erath, *et al.*

William James Samford, Jr., on behalf of the Alabama Public Service Commission Special Counsel

Charles F. Reusch, Theresa J. Burns, C. Stephen Angle for the Staff of the Federal Energy Regulatory Commission

This proceeding involves a Petition for a Declaratory Order filed by Southern Company Services, Inc. on behalf of Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company and Southern Company Services, Inc., and a Complaint filed by Gulf States Utilities Company. The Commission consolidated these two filings for hearing and decision due to common questions of law and fact. A related contracts and commercial torts action is pending in the Federal District Court for the Eastern District of Texas. The principal issues before this Commission involve (1) an interpretation of the Unit Power Sales Agreement and the Interchange Contract; (2) a determination of whether these contracts are unjust, unreasonable, unduly discriminatory or preferential or contrary to the public interest under Section 206(a) of the Federal Power Act; and (3) a determination of whether Texas and Louisiana public utility commission decisions denying pass-through of capacity charges have excused, or rendered impossible, Gulf States' performance under these contracts. Gulf States seeks a significant modification of the contracts to eliminate its obligations to Southern. Southern urges the Commission to enforce the contracts.

Procedural Background

On July 2, 1986, Gulf States Utilities Company (GSU) filed suit in the Federal District Court for the Eastern District of Texas against The Southern Company (Southern), which is comprised of Alabama Power Company, Georgia Power Company, Gulf Power Company and Mississippi Power Company alleging that (1) Southern violated Section 2.2.1 of the Unit Power Sales Agreement (UPSA) and Schedule E of the Inter-

change Contract and thereby violated Texas consumer and tort law; and (2) unforeseen and supervening circumstances have voided the contracts. *Gulf States Utilities Co.* v. *Alabama Power Co.*, No. B-86-634-CA (E.D. Tex.).

On August 25, 1986, Southern Company Services, Inc. (SCSI), a subsidiary of The Southern Company, filed a Petition for a Declaratory Order from the Commission in Docket No. EL86-53-000. Southern sought a declaratory order stating that (1) the Commission has exclusive or primary jurisdiction over the contracts under Section 206(a) of the Federal Power Act; (2) Southern discharged its obligations under Section 2.2.1 of the UPSA by bargaining in good faith, but was under no obligation to reach agreement; (3) Section 2.2.1 does not relate to the Interchange Contract or to Schedule E therein. In the alternative, SCSI requested an order requiring GSU to show cause why (1) it has not complied with the contracts; and (2) it has attempted to avoid Commission jurisdiction by filing suit in Federal District Court.

On November 14, 1986, SCSI amended its petition by requesting an additional 23 declarations. SCSI did so in response to GSU's October 15 amendment of its complaint in Federal Court.

On August 28, 1986, GSU filed a complaint requesting the Commission to release it from its obligations to Southern under the UPSA and Interchange Contract due to unforeseen and supervening circumstances which had voided the agreements and due to the unjust and unreasonable nature of the contracts under Section 206(a) of the Federal Power Act in Docket No. EL86-57-000.

On September 18, 1986, GSU filed a motion for expedited consideration of its complaint due to the company's alleged precarious financial situation.

Notice of SCSI's petition in Docket No. EL86-53-000 was published in the *Federal Register* at 51 Fed. Reg. 32,242 (1986) with comments due on or before September 18, 1986. Timely

motions to intervene in support of the petition were filed by Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company, Sam Rayburn Generation and Transmission Cooperative, Inc. (SRG&T), and Oglethorpe Power Corporation (Oglethorpe). GSU filed a timely motion to intervene in opposition to the petition requesting the Commission to deny Southern's petition and, failing that, to consolidate Docket Nos. EL86-53-000 and EL86-57-000, order the proceedings to be expedited, and to pronounce that the Commission's proceeding does not interfere with the Federal Court proceedings addressing GSU's state law claims.

On October 3, 1986, SCSI filed a response to GSU's motion to intervene. SCSI did not oppose the motion to intervene.

Notice of GSU's complaint in Docket No. EL86-57-000 was published in the *Federal Register* at 51 Fed. Reg. 32,241 (1986), with comments due on or before September 30, 1986. Timely motions to intervene were filed by the Louisiana Public Service Commission (LPSC), the Towns, SRG&T, and Brazos Electric Power Cooperative, Inc. (Brazos). The Public Utility Commission of Texas (PUTC) filed a notice of intervention on September 29, 1986, but moved to withdraw its intervention on October 24, 1986. GSU opposed the motion to withdraw.

On September 30, 1986, Southern filed an answer opposing GSU's complaint. Southern denied all of the allegations but one and opposed the request for an expedited hearing.

On December 15, 1986, the Commission issued an order which (1) granted all of the timely motions to intervene filed in Docket Nos. EL86-53-000 and EL86-57-000; (2) granted PUCT's motion to withdraw its notice of intervention from Docket No. EL86-57-000; (3) granted in part Southern's Petition for a Declaratory Order; (4) set the issues over which the Commission had assumed jurisdiction for hearing; (5) ordered a prehearing conference to take place within 15 days and an initial decision to be issued by the Presiding Judge within 120 days of the date of the order; (6) terminated subdockets 000 of

Docket Nos. EL86-53 and EL86-57 and consolidated sub-dockets 001 for hearing and decision. *Southern Company Services, Inc.*, 37 FERC ¶ 61,256 (1986).

A prehearing conference was held on December 23, 1986. Data requests were directed to be filed by December 26, 1986. The parties' responses to data requests were due January 12, 1987. GSU and Southern filed their initial testimony on January 20, 1987. By January 23, 1987, all parties completed the taking of depositions. On February 2, 1987, GSU and Southern submitted their reply testimony, and the Staff and intervenors filed their initial testimony. An informal technical conference was held on February 10, 1987. On February 17, 1987, GSU and Southern filed their rebuttal testimony, and the Staff and Intervenors filed their cross-rebuttal.

On February 17, 1987, the Commission extended the 120-day decision deadline to April 28, 1987 at the request of the parties.

GSU, Southern, and the Staff filed their surrebuttal on February 24, 1987. Hearings were held before the Presiding Judge from February 24, 1987 through March 17, 1987. A further extension of the decision deadline to May 12, 1987 was granted by the Commission at the request of the parties on March 23, 1987.

The parties filed their initial briefs on April 15, 1987 and their reply briefs on April 24, 1987.

Factual Background

The Southern Company is a public utility holding company which controls four wholly owned subsidiaries, Alabama Power Company, Georgia Power Company, Gulf Power Company, and Mississippi Power Company. Southern Company Services, Inc. is a wholly owned service company which provides engineering, accounting, data processing, and other services for the other Southern companies. SCSI also acts as the agent for Southern in regard to the implementation and administration of its contractual relationship with GSU.

Oil prices increased sharply in the mid-1970's, due to the Arab oil embargo, and as a result, Southern found itself in possession of a large amount of valuable coal generating capacity. Southern mostly produced coal-fired power and had coal-fired and nuclear plants under construction. A recession diminished industrial activity in the Southeast, causing demand from Southern's native load to decrease. Rather than go to the expense of cancelling or delaying construction of the new plants, Southern made a concerted effort to sell its economical, coal-fired capacity and energy to neighboring utilities who depended primarily on oil and gas. Southern initially marketed this capacity and energy as long-term power under Schedule E from its reserves. Southern based the price of this long-term power on the embedded cost of its coal-fired plants and priced the energy at the incremental cost of production on an hour-by-hour basis. The sale of long-term power was not firm, i.e., it was recallable by Southern if it needed the power for its native load.

In 1980, two Florida utilities, Florida Power & Light Company (FP&L) & Jacksonville Electric Authority (JEA), requested Southern to sell them power in addition to that purchased under their long-term power sales contracts. Southern contracted to sell them additional power under unit power sales agreements. On February 19, 1981, FP&L entered into a UPSA agreement with Southern, and on February 27, 1981, JEA entered into its UPSA with Southern. The UPSAs provided for future sales of power primarily from units that were not yet completed. These contracts dedicated the use of designated units to the Florida utilities, so even though the units remained physically on Southern's system, the units were treated as if they were part of the Florida systems. The unit power sales were firm. Southern priced the energy in the unit power sales based on the specific units from which the power was being sold. The UPSA power was more expensive than long-term power because of the expense entailed in building new plants. A Section 2.2.1, similar to the one in the GSU UPSA, was included in these contracts because Southern

would not agree to a Florida utility's request to change capacity on a rolling five-year notice basis. Section 2.2.1 provides that the parties will negotiate in good faith and with diligence with reference to reasonable alternatives when a party requests a change in capacity. These UPSAs also contain a "most favored nations clause" which provides that if Southern made unit power sales to other nonaffiliated utilities from lower cost units, then the cost of unit power sold to these Florida utilities would be correspondingly lowered.

GSU approached Southern in mid-1981 to discuss the possibility of purchasing Tennessee Valley Authority power through the Southern System. Representatives of GSU and Houston Lighting & Power Company (HL&P) met with Southern in August of that year. Southern informed GSU and HL&P that it had 1,000 MW of additional unit power available for sale. Both companies expressed interest in purchasing a portion of that power.

On February 25, 1982, Southern and GSU executed three contracts, a Unit Power Sales Agreement, an Interchange Contract, and a Transmission Facilities Agreement. The UPSA committed GSU to purchase 500 MW/year of capacity and of energy associated with that capacity from designated units beginning in June 1984, and ending in May 1992. The units designated to the Southern-GSU UPSA were Units 1-4 of the Miller Plant, Units 1-4 of the Scherer Plant, and Units 1 and 2 of the Daniel Plant. The same ten coal-fired units were designated in Southern's UPSA with FP&L, as amended in February 1982. The Interchange Contract provided for the first interconnection between Southern's and GSU's electric facilities. The Interchange Contract specifies the terms and conditions governing the interconnection, the points of interconnection, and the rate schedules for short term or emergency power sales. Finally, the Transmission Facilities Agreement spells out the terms and conditions of construction of a 500-kV transmission line from Southern's Daniel Plant to GSU's McKnight substation. GSU does not contest the Transmission Facilities Agreement.

When GSU entered into these contracts with Southern, its generation was almost entirely gas-or oil-fired. GSU had a 20-year contract with Exxon. This contract provided GSU with almost half of its supply of gas at the then very favorable price of 23¢per Mcf and was due to expire January 1, 1985. GSU had the River Bend Nuclear Plant under construction but, nevertheless, forecasted a need for 500 MW in the interim period between June 1983 and March 1992. GSU's Board of Directors set the start-up date for the River Bend Nuclear Plant for January 1, 1986. GSU considered building a 540-MW coal-fired unit, the Nelson 5, but opted to buy 500 MW of coal-fired energy from Southern instead. GSU stated that it expected to use Southern's inexpensive coal-fired power, plus its own nuclear and coal-fired power, to meet base-load requirements and to use GSU's expensive gas-and oil-fired power to meet demand during peak periods.

In March 1982, HL&P notified Southern and GSU that it had decided against the purchase of the 500 MW of unit power which it had requested from Southern. On May 12, 1982, Southern and GSU agreed to amend the UPSA contract to increase the amount of capacity to 1,000 MW per year beginning June 1, 1985. This constituted Amendment No. 1 to the UPSA.

On June 7, 1982, Southern filed the UPSA, the Interchange Contract, and the Transmission Facilities Agreement with this Commission. Southern's wholesale sales represent about seven percent of its total sales and are subject to this Commission's regulation. GSU executed a Certificate of Concurrence as part of the initial filing. The Commission assigned Docket No. ER82-579-000 to the contracts. On January 21, 1983 [22 FERC ¶ 61,047], the Commission issued an order accepting the three contracts for filing effective June 1, 1984 and scheduling a hearing under Section 206(a) of the Federal Power Act to determine the justness and reasonableness of these contracts.

In mid-1983, GSU revised its load and gas price projections downward and became concerned that it would not need the

1,000 MW of capacity. Coal was losing its competitive edge over gas and oil as oil and gas prices were dropping. Demand was dropping due to the depressed economy in GSU's service area. The River Bend Nuclear Plant was nearing completion and GSU was anticipating the resulting need to increase its base rates.

Prehearing conferences were held February 8 and March 1, 1983, but the parties were unable to reach a settlement. The Administrative Law Judge in that proceeding issued a procedural schedule for discovery and scheduled a third prehearing conference for May 25, 1983. The Staff and the Louisiana Public Service Commission filed direct testimony.

After LPSC filed its testimony, GSU requested Southern to agree to negotiate further changes to the UPSA under Section 2.2.1. In September 1983, the Chief Executive Officer (CEO) of GSU met with the President of SCSI. At the meeting, the CEO of GSU explained the effect of changed economic circumstances upon his company and requested Southern to delete Amendment No. 1. Southern agreed to negotiate with GSU and to evaluate reasonable alternatives. A series of meetings and settlement conferences followed. Southern proposed amendment of the contracts by shifting a portion of the more expensive UPSA capacity requirements to the cheaper Schedule E power under the Interchange Contract. The parties negotiated a basis for settlement and discussed it with the Staff and intervenors at the October 21, 1983 settlement conference.

On December 6, 1983, the parties amended the UPSA with Amendment No. 2 and added a new rate schedule, Service Schedule E, to the Interchange Contract. The 1983 amendments did not reduce the overall amount of capacity which GSU was obligated to purchase from Southern, but they did give GSU some relief by converting some of the UPSA capacity obligation to Schedule E. The UPSA capacity obligation was reduced to 400 MW for 1985, 500 MW for 1986, 600 MW for 1987, and 700 MW for 1988-1992. GSU's obligation under the Interchange Contract changed correspondingly; i.e., 600 MW

for 1985, 500 MW for 1986, 400 MW for 1987, and 300 MW for 1988-1992. Southern estimates that this shift in the mix between UPSA and Schedule E capacity obligations resulted in a savings for GSU of between $350-$400 million over the term of the contracts.

Schedule E to the Interchange Contract between GSU and Southern resembles the long-term sales of energy which Southern made in the early years of the oil crisis to the Florida utilities. Schedule E allowed GSU to purchase nonfirm coal-fired capacity from Southern's reserves. The price was based on the embedded cost of Southern's coal-fired plants using Southern's incremental cost of production. As in the previous long-term sales, Schedule E capacity and energy are cheaper than UPS capacity and energy.

The 1983 amendments also added Sections 2.2.4 and 2.2.5 to the UPSA. Section 2.2.4 provides for the automatic substitution by Southern of UPSA capacity for Schedule E capacity should GSU's avoided costs exceed the average cost of its purchases during the previous eleven months. Section 2.2.4 thus avoids the possibility of GSU receiving a windfall from Southern's 1983 concessions should economic conditions later reverse themselves.

Section 2.2.5, added at GSU's request, relieves GSU of its purchase obligations under the UPSA to the extent that Southern can sell that capacity to third parties, except Middle South, in Texas or Louisiana or to the extent that GSU can obtain a purchaser from anywhere. Thus, Section 2.2.5 provides GSU an opportunity to unilaterally avoid its obligations under the UPSA by finding a substitute purchaser.

Southern filed the settlement agreement reflecting the 1983 amendments with the Administrative Law Judge and requested him to certify the settlement to the Commission for approval. GSU joined in this request. LPSC did not oppose the settlement, and the Staff filed comments supporting the settlement agreement. On March 23, 1984, the Commission approved the settlement and held that the amended contracts

were "just and reasonable and in the public interest." *See, Southern Company Services, Inc.*, 26 FERC ¶61,360 (1984). The transmission line was completed in early 1984 and Southern commenced sales under Schedule E in May 1984, and under the UPSA in January 1985. The LPSC and the PUCT permitted pass-through of the UPSA and Schedule E costs to GSU's retail customers.

On August 26, 1985, the Interchange Contract was amended by adding Schedule R, which Southern unilaterally offered to all of its UPSA customers effective August 2, 1985. Schedule R allows GSU to purchase energy which is less expensive than that under the UPSA and allows GSU to apply it against the minimum take requirements under the UPSA. GSU stated, in its letter accepting Schedule R, that its acceptance of Schedule R did not constitute a waiver of its rights under Section 2.2.1. Southern filed Schedule R with the Commission on August 29, 1985, and the Commission approved it on September 30, 1985 [unreported]. Southern estimated that Schedule R saved GSU as much as $20 million between September 1985 and December 1986.

By 1985, circumstances had worsened for GSU. The advantages of coal over oil and gas had decreased because of a drop in oil and gas prices. A reduction in GSU's load occurred as a result of an increase in customer cogeneration and the effects of the recession upon industry in GSU's service area. Due to decreased demand, GSU experienced larger reserve margins than expected. Higher reserve margins and the drop in gas prices caused GSU's incremental cost of generating power to fall. Construction of the River Bend Nuclear Plant was almost complete and GSU was committed to the Cajun Electric Power Cooperative, Inc. (Cajun) buyback pursuant to which it was buying back the interest in Cajun's River Bend Nuclear Plant.

In addition, GSU was experiencing difficulties with the LPSC and the PUCT. In anticipation of the commercial operation of the River Bend Nuclear Plant, GSU filed for a $113 million rate increase from PUCT. Notwithstanding evidence

submitted by GSU to the PUCT establishing that the contracts were prudent and beneficial, PUCT indicated an intent to order a $120 million rate reduction. Six months later, in May 1986, GSU agreed to accept an $80 million rate decrease from PUCT, and PUCT issued an order establishing favorable accounting treatment pertaining to the River Bend Nuclear Plant. Approximately $55 million of the $80 million rate decrease was attributable to costs associated with the Southern-GSU contracts. A portion of this decrease consisted of the temporary denial of GSU's right to pass on the Texas share of its capacity payments under Schedule E and the UPSA to its Texas ratepayers. The PUCT based its denial of pass-through on a finding of "imprudence" on the part of GSU in entering into the contracts. On October 3, 1986, the PUCT made the denial permanent. In November 13, 1986, LPSC denied GSU the right to pass on the Louisiana share of its capacity payments to its Louisiana rate payers. GSU is seeking review of both these actions. On September 8, 1986 and November 18, 1986, respectively, GSU filed in Louisiana and Texas for $182 million of interim rate relief. LPSC denied the request in December 1986, and GSU appealed its decision. LPSC granted GSU interim rate relief in the amount of $57 million in February 1987. The PUCT provided $39.9 million in interim rate relief in April 1987 conditioned upon GSU establishing a line of credit.

In August 1985, GSU orally requested Southern to decrease, or abrogate, its purchase obligations under the UPSA and the Interchange Contract. GSU and Southern met repeatedly throughout the fall of 1985 to discuss GSU's economic situation and possible alternatives. GSU offered to let Southern audit its books and attend meetings with regulators. Southern declined to audit the books but did attend the meetings with regulators. On January 8, 1986, GSU formally requested Southern by letter to commence negotiations to eliminate or suspend sales of capacity under the UPSA pursuant to Section 2.2.1. On January 20, 1986, Southern submitted a letter which responded to GSU's letter by agreeing to negotiate and discuss alternatives. The Southern letter expres-

sly stated, however, that its actions in agreeing to do so did not signify acceptance of GSU's interpretation of Section 2.2.1. The Southern letter also reminded GSU of the concessions which Southern had made in 1983 and stated "[i]t was our position at the time that these substantial concessions would be the extent of any decreases in unit power capacity sales."

The parties continued to negotiate and propose possible alternatives until GSU filed suit on July 2, 1986, in Federal District Court charging Southern with breach of contract, the torts of bad faith dealing and fraud, and a violation of the Texas Deceptive Practices-Consumers Protection Act. GSU proposed the following alternatives: (1) eliminate all of GSU's capacity cost obligations under the UPSA; (2) "cut and extend" GSU's annual UPSA and Schedule E capacity purchase obligations for three years and extend the terms of the contracts by three years; (3) convert the UPSA capacity purchase obligations to Schedule E capacity purchase obligations for three years and extend the terms of the contracts by three years; and (4) merge GSU into Southern or arrange for Southern to acquire GSU. Southern proposed the following alternatives: (1) defer GSU's duty to pay but have GSU provide security for the debt; and (2) have GSU buy ownership interest in Southern's Scherer Unit 4 in satisfaction of its obligations under the UPSA.

Upon filing the lawsuit in Federal District Court, GSU sought and obtained permission from the court to deposit into the registry of the court all money which GSU owed Southern under the contracts, but which was at issue in the case. GSU maintains that it ceased making deposits of the Texas and Louisiana retail portions of the capacity charges when the PUCT and the LPSC barred it from recovering the Southern retail capacity charges from ratepayers. As of January 15, 1987, GSU was still paying the wholesale portion of capacity charges into the registry of the court and was paying Southern an amount equal to the avoided cost of the energy which GSU purchases from Southern.

Positions of the Parties

1. GSU

GSU maintains that unforeseen changes in circumstances have transformed the UPSA and the Interchange Contract with Southern into unjust, unreasonable, unduly discriminatory or preferential contracts that are contrary to the public interest. GSU requests the Presiding Judge to find, pursuant to this Commission's authority under Section 206(a) of the Federal Power Act, that the UPSA and Schedule E of the Interchange Contract are no longer just, reasonable and in furtherance of the public interest. Should the Presiding Judge make this finding, GSU requests that the contracts be modified to provide that (1) GSU is required to purchase energy from Southern only when the price is at, or below, GSU's own avoided cost, and (2) Southern is allowed to recover capacity charges only to the extent that the total amount it is charging GSU for capacity and energy does not exceed GSU's avoided cost.

2. SRG&T

SRG&T, a wholesale customer of GSU, supports GSU's position arguing that the UPSA and Schedule E rates are currently unjust and unreasonable because they exceed GSU's avoided costs. SRG&T requests the Presiding Judge to find that the UPSA and Schedule E are unjust and unreasonable insofar as they impose take-or-pay capacity charges, minimum energy charges, or rates in excess of GSU's avoided cost.

3. LPSC

The LPSC, a state regulatory body having jurisdiction over part of GSU's service area, supports GSU's position. The LPSC maintains that the purpose of the contracts it to provide displacement energy for GSU and that such purpose is frustrated when the rates exceed GSU's avoided costs. The LPSC requests the Presiding Judge to find that the costs and benefits

realized between the parties are so unjustly and unreasonably disproportioned that the contracts are no longer lawful. The LPSC further requests the Presiding Judge to void or modify the contracts to the extent necessary to provide GSU with the benefit it contracted for, i.e., lower costs displacement energy.

4. Southern

Southern maintains that the contract rates are based upon its cost-of-service and that they were found just and reasonable by the Commission and continue to be just and reasonable today. Southern further argues that the UPSA and the Interchange Contract are not unduly discriminatory or preferential in that GSU is not being treated differently from any of Southern's similarly situated customers. Southern requests the Presiding Judge to grant Southern's Petition for Declaratory Order and to reject GSU's Section 206(a) complaint.

5. Oglethorpe

Oglethorpe is one of Georgia Power Company's wholesale customers; Georgia Power Company is a subsidiary of Southern. Oglethorpe supports Southern's position and adds that granting relief to GSU would entail shifting costs from GSU to Southern's customers, shareholders and co-tenants. Oglethorpe joins in Southern's request for rejection of the Section 206(a) complaint and for issuance of Southern's Declaratory Order.

6. Staff

Staff argues that the Commission has previously found these contracts to be just and reasonable and that none of the ensuing changes in circumstances were unforeseeable. It stresses that GSU's current financial problems stem directly from the failure of the state commissions to grant adequate retail rates. Staff requests the Presiding Judge to reject GSU's Section 206(a) complaint and to rule on Southern's Petition for Declaratory Order in accordance with its positions in its initial brief.

Discussion

Prior to the hearings herein, the parties agreed upon twenty-five issues to be litigated and determined in this proceeding. These will be set forth and addressed below in the order in which they were presented.

Section 206(a)

Issue 1: Whether the Unit Power Sales Agreement is unjust, unreasonable, unduly discriminatory or preferential under the standards of Section 206(a) of the Federal Power Act?

Issue 2: Whether Schedule E of the Interchange Agreement is unjust, unreasonable, unduly discriminatory or preferential under the standards of Section 206(a) of the Federal Power Act?

These two issues are clearly the threshold issues since Section 206(a) of the Federal Power Act provides the seminal authority pursuant to which the Commission may act upon the Petition for Declaratory Order and the complaint giving rise to this proceeding.

Section 206(a) provides as follows:

> (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charges, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. [49 Stat. 852; 16 U.S.C. 824e(a)]

Under Section 206(a), the Commission must first find that an existing "rate, charge(s) or classification," or a "rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or pref-

erential" before it can modify a contract under Section 206(a). Thus, before considering any proposed modification of the existing contracts, i.e., the UPSA and Schedule E of the Interchange Contract, these contracts must be examined to determine whether they are unjust, unreasonable, unduly discriminatory or preferential or contrary to the public interest under the terms of Section 206(a).

At the outset, it is noted that the contracts at issue were the subject of a Commission order, issued March 23, 1984, approving a settlement. *Southern Company Services, Inc.*, 26 FERC ¶61,360 (1984). In this order, the Commission held that the UPSA and the Interchange Contract were "just and reasonable and in the public interest." The same contracts are again before the Commission upon GSU's complaint and Southern's petition.

Burden of Proof

Southern first asserts that under *Seminole Electric Cooperative, Inc.*, 32 FERC ¶63,087, at p. 65,334 (1985) and *Central Iowa Power Cooperative* v. *F.E.R.C.*, 606 F.2d 1156, 1161 n. 11 (D.C. Cir. 1979), GSU has the burden of proof in regard to its Section 206(a) complaint. Southern also acknowledges that is possesses at least the burden of going forward in regard to its Petition for Declaratory Order.

Staff maintains that GSU has not proved that the contracts are unjust or unreasonable under Section 206(a). Implicit in this assertion is the claim that GSU bears the burden of proof.

GSU does not take issue with Southern's position on burden of proof to the proper standards to be applied. In its argument, SRG&T assumes that is possesses the burden of proof in regard to the Section 206(a) issue.

Southern's position on burden of proof in this proceeding is accepted.

Commission Authority Under Section 206(a)

GSU, SRG&T and LPSC contend that the Commission has authority under the "just and reasonable" standard of Section

206(a) to provide GSU relief from its obligation to purchase capacity from Southern under the UPSA and Schedule E of the Interchange Contract. Both GSU and SRG&T rely upon the "just and reasonable" standard, rather than upon the stricter "public interest" standard set forth in the *Sierra-Mobile* cases, *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956) and *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and more recently passed upon in *Papago Tribal Utility Authority* v. *F.E.R.C.*, 723 F.2d 950 (D.C. Cir. 1983), *cert. denied*, 467 U.S. 1241 (1984).

GSU contends that the "just and reasonable" standard applies because these contracts expressly provide for the Commission's authority to change the rates set by the contracts. It refers to Sections 1.1 of the UPSA and 2.1 of the Interchange Contract. Section 1.1 of the UPSA provides as follows:

> [S]uch rates, terms and conditions as are approved in the applicable final order shall control for purposes of this Agreement subject to change by mutual agreement or by subsequent final orders of FERC.

GSU claims that Section 2.1 of the Interchange Contract is virtually identical to Section 1.1 of the UPSA. It cites *Public Service Co.* v. *F.E.R.C.*, 628 F.2d 1267 (10th Cir. 1980), *cert. denied sub nom.*, *City of Gallup* v. *F.E.R.C.*, 451 U.S. 907 (1981), *Louisiana Power & Light Co.* v. *F.E.R.C.*, 587 F.2d 671 (5th Cir. 1979), and *South Texas Natural Gas Gathering Co.*, 55 FPC 904 (1976) as providing examples of instances where similar contract provisions were held to justify the application of the "just and reasonable" standard under Section 206(a).

GSU contends that the right to request the Commission to modify the contract under a "just and reasonable" standard is supported by Section 2.2.1 of the UPSA (in which the parties agree to negotiate in good faith as to changes in capacity), by the preamble to Section 2.2.1 (in which the parties recognize that the basis for sales and purchases of capacity is subject to change), by Section 5.4 of the UPSA (in which GSU reserves its rights to seek relief from the Commission under Section 206(a)

from discriminatory or unreasonable charges), and by Section 4.3 of the Interchange Contract (in which the parties reserve their right to seek relief from the Commission should their attempts to reach mutual agreement fail). Based upon these provisions, GSU concludes that the contracts contemplate "'the Commission's review, and potential reform of their agreement,'" and thus the "just and reasonable" standard applies.

GSU further argues that the language in Section 2.2.1, which prohibits change absent mutual written agreement, forecloses unilateral change by a party under Section 205 but does not foreclose change by Commission order. GSU cites *Pacific Power & Light Co.*, 33 FERC ¶ 61,357 (1985), as support for its interpretation of Section 2.2.1. GSU further cites *Kentucky Utilities Co.*, 49 FPC 1470, *aff'd*, 529 F.2d 342 (D.C. Cir.), *cert. denied*, 429 U.S. 816 (1976), as authority for the proposition that where a contract contains a mutual agreement clause and the parties negotiate, but are unable to agree, the Commission will utilize the "just and reasonable" standard to establish a rate.

Finally, GSU argues that under *Kansas Cities* v. *F.E.R.C.*, 723 F.2d 82 (D.C. Cir. 1983), where the contract is ambiguous, the Commission should adopt the "just and reasonable" standard rather than the *Sierra-Mobile* "public interest" standard.

The LPSC reiterates GSU's argument as to whether the "just and reasonable" standard or the *Sierra-Mobile* "public interest" standard applies. It concludes that the UPSA and the Interchange Contract anticipate continuing Federal Energy Regulatory Commission review and, thus, the contracts may be declared unlawful upon a showing that they are unjust, unreasonable, unduly discriminatory or preferential.

SRG&T argues that the "just and reasonable" standard properly applies to this proceeding. It contends that Section 5.3 of the UPSA provides Southern with the right to unilaterally apply to the Commission for a rate change. SRG&T further argues that Sections 5.4 of the UPSA and 4.3 of the Interchange Contract reserve the GSU's right to seek relief

from the Commission under Section 206(a) of the Federal Power Act. SRG&T relies on *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958), *Mississippi Industries* v. *F.E.R.C.*, 808 F.2d 1525 (D.C. Cir. 1987), *petition for cert. filed sub nom., Arkansas Public Service Comm'n* v. *F.E.R.C.*, 55 U.S.L.W. 3682 (Feb. 20, 1987) (No. 86-1380), in support of its position. Additionally, SRG&T cites *Consumer Advocate Division of the West Virginia Public Service Commission* v. *Allegheny Generating Co.*, 39 FERC ¶ 63,004 (1987) for the proposition that where the contract gave the seeking utility the right to unilaterally file for a rate change and gave the parties the right to file a complaint under Section 206(a), modification of the contract by the Commission does not deprive the parties of the benefits of their bargain because the contract specifically provides for such modification. Although GSU and SRG&T eschew the "public interest" standard of *Sierra-Mobile*, they assert that the "just and reasonable" standard incorporates some public interest factors.

While Southern expresses some surprise, in light of extensive references in the record to the public interest, that GSU and SRG&T now rely on the "just and reasonable" standard, rather than the "public interest" standard, it apparently does not take issue with this distinction. Southern does, however, vigorously contest the manner in which GSU and SRG&T attempt to apply the "just and reasonable" standard of Section 206(a) to the facts in this proceeding.

Staff rejects the contention that the Commission may abrogate the contracts herein on the basis of the "public interest" standard of *Sierra-Mobile*, arguing that the facts in this case are distinguishable from those in *Sierra-Mobile*. Staff relies on the rate standards of Section 206(a), contending that GSU has not made a case for the relief it requests.

No party contests the Commission's right to review the contracts under Section 206(a), and there appears to be a consensus among the parties that the determination of GSU's complaint necessarily involves the "just and reasonable" stan-

dard as set forth in Section 206(a). The facts in this case are distinguishable from those in the *Sierra-Mobile* cases. The issue in *Sierra-Mobile* involved the right of a seller to unilaterally modify a rate under a fixed-rate contract in the absence of a contractual provision permitting the parties to unilaterally change the rate. The Court held that under such circumstances, the Commission could modify the contract rate where the rate was contrary to the public interest, notwithstanding the absence of a contractual provision permitting any of the parties to unilaterally make such a change. In *Papago II*, the court referred to the Commission's "indefeasible right" under Section 206(a) to replace rates that are contrary to the public interest in addition to the standards spelled out in Section 206(a). *See*, *Papago Tribal Utility Authority* v. *F.E.R.C.*, 723 F. 2d at 953. Under *Sierra-Mobile*, the Commission may modify the rate if it proves to be so low as to affect the public interest even though the contract rate is just and reasonable as between the seller and purchaser.

In this case, a purchaser, rather than a seller, seeks to change the contracts. Sections 1.1 and 5.4 of the UPSA and Sections 2.1 and 4.3 of the Interchange Contract contemplate Commission review of the rates, charges, terms and conditions of these contracts under Section 206(a). Thus, it is appropriate for the Commission to investigate the contract rates and charges under the "just and reasonable" standard and under its "indefeasible right" to change any rate or charge which is contrary to the public interest. The contract provisions, referred to by GSU and SRG&T as setting forth GSU's right to seek Commission review, do not define the Commission's authority under Section 206(a).

In making their arguments as to the appropriate standard, the parties refer to the "just and reasonable" standard. Section 206(a), however, states that the initial finding thereunder must be that the present rates or charges are "unjust and unreasonable." The positions of the parties will be examined accordingly.

In focusing upon the existing rates and charges under the contracts, neither GSU, nor the supporting intervenors, have

made a showing on the record, or contended on brief, that the rates and charges were not cost-based or were not properly computed under the UPSA or Schedule E. But SRG&T, in a footnote to its initial brief, appears to challenge the present rates of return on equity in the UPSA and in Schedule E, indicating that they exceed the generic benchmark established by the Commission of 11.2 percent (Tr. 2379-80). The rates of return on equity of the UPSA and of Schedule E were not identified as a contested issue in this proceeding. Neither GSU, nor any other party, offered direct evidence on the rate of return. The brief cross-examination by counsel for SRG&T alluded to above does not provide a sufficient basis for a meaningful discussion of this question or for a determination of the rate of return.

GSU asserts generally that it is seeking relief from the grossly unreasonable charges which it is currently obligated to pay under the terms of the contracts. It contends that the obligation to purchase capacity, like the cost allocation provisions in *Mississippi Industries*, directly and significantly affects the wholesale rates charged by Southern. Alternatively, GSU seems to argue that it is immaterial that the specific method of relief it requests is modification of its obligation to purchase capacity because modification of the obligation to purchase capacity is, in effect, a rate change. GSU further argues that even if the relief it seeks is not deemed to constitute a modification to the rate, the requested modification does fall within the provisions of Section 1.1 of the UPSA, which provides that any and all terms and conditions of the UPSA are subject to change by mutual agreement or by final order of this Commission.

The thrust of GSU's position is not that the present contract rates are unjust or unreasonable under the well established cost-based rate methodology, but rather that the charges under the contract are unjust and unreasonable due to a variety of "non-cost factors", to be addressed below, that arise from GSU's obligations to purchase capacity and energy under the UPSA and Schedule E. It argues that these non-cost factors

should be considered along with the cost factors in making a determination as to the justness and reasonableness of the rates and charges. GSU's theory of the case departs from the typical rate adjustment case and introduces some novel concepts on the application of the "just and reasonable" standard.

GSU argues for an interpretation of the phrase "just and reasonable" that extends beyond the question of whether the seller's rates are cost-based. It cites a number of cases in support of its position which, for the reasons indicated, do not establish the validity of its contentions. GSU points to *Farmers Union Central Exchange, Inc.* v. *F.E.R.C.*, 734 F.2d 1486 (D.C. Cir.) *cert. denied sub nom., Association of Oil Pipe Lines* v. *Farmers Union Central Exchange, Inc.*, 469 U.S. 1034 (1984), as authority for the proposition that FERC has an affirmative responsibility to strike a balance that will not only permit sellers to earn a fair return but will at the same time protect buyers, as well as the public, from economic harm.

Southern, however, argues that although the court recognized that "'non-cost' factors may play a legitimate role in the setting of just and reasonable rates," it held that the cost of providing service must be the basis for Commission regulation. It notes that the court began its inquiry into the meaning of "just and reasonable" by observing that "[a]n agency may issue, and courts are without authority to invalidate, rate orders that fall within a "'zone of reasonableness,' where rates are neither 'less than compensatory' nor 'excessive,'" citing *F.E.R.C.* v. *Pennzoil Producing Co.*, 439 U.S. 508, 517 (1979); *Permian Basin Area Rate Cases*, 390 U.S. 747, 797 (1968). Southern states that according to the court, the most useful and reliable starting point for determining whether a rate is "less than compensatory" or "excessive" is an inquiry into costs. It maintains that although the court recognized in this context that "non-cost" factors may play a legitimate role in the setting of rates within the zone of reasonableness, neither this Commission nor the court endorsed the notion now offered by GSU that "non-cost" factors can be used to impose a less than compensatory rate.

Southern further contends that in *Farmer's Union*, the Commission had established an extraordinarily *high* price ceiling, and the question on appeal was whether such action was justified on the basis of non-cost factors. It states that the court found that price ceiling was not justified and that the court admonished the Commission that "[d]epartures from cost-based rates must be made, if at all, only when the non-cost factors are clearly identified and the substitute or supplemental ratemaking methods ensure that the resulting rate levels are justified by those factors." While the Court's opinion makes it clear that non-cost factors may justify the setting of a higher than strictly cost-based rate, there is absolutely nothing in it to suggest that non-cost factors may operate to deprive a selling utility of the recovery of its costs.

GSU further attempts to support its interpretation of "just and reasonable" by discussing the occasions on which the Commission has considered factors other than the seller's costs. GSU cites Order No. 380, which eliminated variable cost minimum bills from pipeline service agreements to the extent that these provisions permit recovery of variable costs, as an example of where the Commission has modified a contract for reasons beyond seller's cost. *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, Order No. 380, 49 Fed. Reg. 22,778 (May 25, 1984) *[FERC Statutes and Regulations, Regulations Preambles 1982-85* ¶ 30,571]. GSU describes the Commission's reasons for doing so as being that (1) minimum bills allow pipelines to charge for gas that their customers do not take, and to the extent that their customers pay for gas not taken, the pipelines recover variable costs that they have not in fact incurred; (2) minimum bills artificially maintain high prices by preventing customers from purchasing gas from other, cheaper sources. GSU states that the D.C. Circuit, in *Wisconsin Gas Co.* v. *F.E.R.C.*, 770 F.2d 1144, 1153 (D.C. Cir. 1985) *cert. denied*, 106 S.Ct. 1968 (1986), upheld the Commission's authority to strike minimum bills under Section 5(a) of the Natural Gas Act, 15 U.S.C. § 717d(a). It further states that the Commission has

continued to strike minimum bill provisions and pipeline tariffs that force purchasers to forego cheaper sources of gas or to pay for costs which weren't actually incurred by the pipeline. GSU cites *ANR Pipeline Co.*, 37 FERC ¶ 61,263 (1986), *Transcontinental Gas Pipe Line Corp.*, 37 FERC ¶ 61,328 (1986), and *Transwestern Pipeline Co.*, 32 FERC ¶ 61,009 (1985) as examples of this. It further asserts that a primary basis for Order No. 380 was the Commission's finding that such minimum commodity bill provisions frequently operate to recover variable costs that are not actually incurred. The Commission stated that:

> By definition, there are no variable costs incurred for volumes not purchased for resale. Accordingly, a minimum commodity bill that includes variable costs gives a pipeline the right to collect for "costs" it has not in fact paid out to provide jurisdictional natural gas service. On its face, then, a minimum bill that permits such "cost" collection is unjust and unreasonable.

49 Fed. Reg. at 22,781 *[FERC Statutes and Regulations, Regulations Preambles 1982-1985* at p. 30,962]. Significantly, the Commission did not strike down all minimum bill provisions; it left intact those portions recovering fixed costs. In Order No. 380, the Commission deleted a provision, which affected the rate, and it proscribed the recovery of costs that were not incurred. The Commission decision in Order No. 380 is readily distinguishable from the instant case because in the instant case the costs have been, and will continue to be, incurred by Southern in fulfilling its contractual obligation to make capacity and energy available to GSU under the UPSA and Schedule E.

GSU further cites *Mississippi Industries* as an example of an instance where the Commission modified a contract because the circumstances had changed so dramatically that the parties' intent was no longer effectuated. GSU states that in *Mississippi Industries*, the Commission modified the contract by reallocating nuclear capacity and related costs among four affiliated companies so as to ease the burden of unanticipated

cost overruns upon the customers. GSU claims that the D.C. Circuit upheld the Commission's actions because the parties belonged to an integrated system of affiliates and the decision to build the nuclear capacity was made for all of their benefit. GSU argues that the contracts here have established the same principle of mutual benefit between itself and Southern even though they are unaffiliated parties.

Southern argues, however, that there are important distinctions between the facts of *Mississippi Industries* and the instant case. Neither this Commission nor the D.C. Circuit suggested that the approved rates should deny a return to Middle South Energy on its Grand Gulf nuclear unit investment or that the parties' contract should be abrogated entirely. Rather, it asserts that the decision turned on the related findings that the Middle South system was a highly integrated operation that made crucial decisions as a single entity (including the construction decision relating to Grand Gulf), and that the allocation agreed upon by these affiliated companies was discriminatory because it did not match costs with the incurrence of costs. Moreover, Southern maintains that the court in *Mississippi Industries* expressly recognized that the decision would have been different had the contract at issue been between non-affiliates. It states that in this case the relief sought by GSU is unrelated to cost incurrence under the contracts and GSU and Southern are not affiliates. It is found that *Mississippi Industries* is inapposite to the instant case.

GSU discusses *Pacific Gas Transmission Co.* v. *F.P.C.*, 536 F.2d 393 (D.C. Cir.), *cert. denied*, 429 U.S. 999 (1976), as an example of an instance where the Commission has modified a contract because the contract inhibits the Commission from protecting the consumers. It states that in *Pacific Gas*, the Federal Power Commission issued an order modifying an automatic rate increase provision in a contractually-based tariff which was tied to the seller's costs. GSU states that the Commission modified the provision because it prevented the Commission from protecting the buying utility, and ultimately

consumers, from unjust and unreasonable rates resulting from massive inflation in the seller's costs.

Southern argues that the Federal Power Commission in *Pacific Gas* did not deny recovery of gas costs incurred by Pacific Gas, but rather modified the tariff to require Pacific Gas to make a filing with the Commission including such costs in its rates. The court found that the Federal Power Commission's desire to review these costs, which were established by Canadian authorities, was entirely consistent with the Commission's obligations under Section 4 of the Natural Gas Act. Southern properly concludes that the case does not hold that cost recovery can be denied or ignored.

GSU cites *Chattanooga Gas Co.* v. *East Tennessee Natural Gas Co.*, 35 FPC 902 (1966), as a further example of the Commission modifying a contract because it precluded the buyer from taking advantage of alternative, cheaper supplies of energy. GSU states that in *Chattanooga Gas*, the Commission modified a sole source contract by reducing the buyer's purchase obligation because the seller lacked the capacity to meet the contract maximum, because the seller did not appear to have relied on the maximum terms, and because the contract barred Commission consideration of proposals which might reasonably have resulted in lower prices to the ultimate consumer.

Southern asserts that, in its discussion of *Chattanooga Gas*, GSU fails to address the following crucial factual findings made by the Commission: (1) there was no evidence that either of the parties placed any reliance upon the 40,000 Mcf limitation; (2) the seller admitted that "it would be physically impossible to supply the 40,000 Mcf on a sustained basis with existing facilities"; (3) the 40,000 Mcf provision had no revenue or cost significance to the seller, since the buyer paid a monthly demand charge based on its actual maximum take during the preceding 12-month period; and (4) the protection afforded by the contract demand was "more illusory than real" because the

seller "ha[d] not constructed the facilities required to provide the 40,000 Mcf." 35 FPC at pp. 906-907. Southern further argues that, in addition to these important factors, none of which apply to this case, the Judge also concluded that the other customers of the seller would be unaffected by the change and, in fact, had intervened in the proceeding in support of the buyer's request. Southern maintains that it was on this basis that the Judge concluded that "the relief is reasonable as to [the seller's] customers." Finally, Southern states the Judge observed that if the seller "goes on selling the same amounts of gas at the same prices as before, it will not have been deprived of its right to a reasonable return," a determination consistent with the Commission's above-noted finding that the requested change had "no revenue or cost significance" to the seller. 35 FPC at 915. Southern has amply demonstrated that such is not the case here.

Finally, GSU refers to *Cities Service Gas Co.* v. *Mobil Oil Corp.*, 44 FPC 295, 304 (1970) as a further example of modification of a contract by the Commission due, at least in part, to adverse impact upon the customer. GSU's reliance on *Cities Service Gas* is misplaced. First, *Cities Service Gas* is not a Commission decision. The Commission merely approved a settlement of the proceeding. Second, the Judge's determination that Cities Service should be relieved of its existing take-or-pay provision was based on the fact that Cities could avoid a large take-or-pay penalty only by running the risk of depleting the field reserves or by expanding its facilities at a time when the deliverability of gas from the field was declining. Notably, Cities' action in taking larger amounts would have affected other producers in the field besides the seller. Thus, unlike the contracts herein, modification of the contract had public interest implications beyond its impact on the purchaser. Moreover, the Judge did not delete the take-or-pay provision as GSU requests here. Instead, he modified it to match the seller's ratable share of Cities' purchase capability in the field. The facts in *Cities Service Gas* and the relief requested are com-

pletely distinguishable from the facts herein and the relief requested by GSU.

It is concluded that the cases cited by GSU fail to provide support for its theory of the case or for the relief it seeks.

SRG&T supports GSU's argument that the scope of the "just and reasonable" standard should extend past the question of whether the seller's rates are cost-based. It concedes that the Commission has traditionally relied on cost-of-service analysis to protect the interests of the consumer, but argues, as the court in *City of Chicago* v. *F.P.C.*, 458 F.2d 731, 751 (D.C. Cir. 1971) explained, that producer costs are utilized because there are not any other factors available to evaluate the rate from the consumer's standpoint. SRG&T argues that this paucity of evidence assumes the typical full requirements customer who, unlike GSU, lacks alternatives such as purchases from other sources or self-generation. It points out that the Supreme Court in *Wisconsin* v. *F.P.C.*, 373 U.S. 294, 309 (1963), held that "no single method need be followed by the Commission in considering the justness and reasonableness of rates." SRG&T argues that where the circumstances are appropriate, the Commission and the courts are willing to look at a buyer's circumstances to determine just and reasonable rates. It refers to coordination or economy transactions, natural gas curtailment cases, and the development of remedies for price squeeze as examples of instances where the Commission has considered the buyer's circumstances in determining a just and reasonable rate, citing *F.P.C.* v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972); *American Smelting & Refining Co.* v. *F.P.C.*, 494 F.2d 925 (D.C. Cir.), *cert. denied*, 419 U.S. 882 (1974); and *F.P.C.* v. *Conway Corp.*, 426 U.S. 271 (1976). SRG&T concludes that in this proceeding, the "just and reasonable" standard entails examination of Southern's cost of service and other cost and non-cost factors, such as GSU's circumstances and avoided costs.

Under its avoided costs theory, SRG&T maintains, without any support in the contract, that GSU's liability extends only to

the payment of its avoided costs at any given time because GSU intended to buy displacement energy rather than unit power when it entered into the contracts. SRG&T's arguments and citation of authority do not add support to GSU's claim for relief. Although a just and reasonable inquiry may encompass an evaluation of non-cost factors, such factors, as demonstrated in the cited cases, relate to rate terms and to contractual provisions affecting such terms. None of the authorities cited by SRG&T support the complete discharge of a contractual obligation for reasons unrelated to the rates or charges or to the contractual provisions affecting them.

SRG&T, in an apparent attempt to align GSU's complaint with the language of Section 206(a), argues that the Commission has plenary authority to relieve GSU of the "take-or-pay capacity" or "minimum energy purchases" provisions of the UPSA and Schedule E, because these provisions directly determine capacity and energy charges under the contract. SRG&T does not offer a specific identification of the relevant provisions relating to the terms noted, or an explanation as to why "take-or-pay capacity" or "minimum energy purchase" provisions in a unit power contract, which is typically designed to provide for a fixed entitlement to capacity and energy, are in themselves unjust or unreasonable. SRG&T further cites Section 2.2.1 of the UPSA and *Mississippi Industries* in support of the relief requested. It maintains that Section 2.2.1 commits the parties to negotiate in good faith upon proposed changes in capacity and argues that the existence of Section 2.2.1 indicates that the parties contemplated changes in capacity. SRG&T cites *Mississippi Industries* as an example of an instance where the Commission modified a provision which is comparable to the "take-or-pay capacity" and "minimum energy purchase" provisions in the UPSA and Schedule E.

Section 2.2.1 of the UPSA does provide that the parties may enter into good faith negotiations with reference to capacity but it does not commit either party to agree. The meaning of Section 2.2.1, as will be discussed with reference to a subsequent issue, is unambiguous. It does not provide a basis for

Commission action apart from its powers under Section 206(a). Reliance on *Mississippi Industries*, as was previously noted, is inapposite to the facts and relief sought herein.

SRG&T argument appears to challenge the essence of unit power purchase contracts since by their very nature they provide for a fixed entitlement to capacity and energy for which compensation is paid. Such an entitlement may be used by the purchaser when needed as if the unit were in fact owned by the purchasing utility. Referring to provisions of a unit power contract as "take-or-pay capacity" or "minimum energy purchase" provisions, conjures up subjects which the Commission has expressed concern about, such as "take-or-pay" obligations under gas contracts in a recent Notice of Issuance of Proposed Policy Statement and Opportunity for Public Comment (issued March 5, 1987, 38 FERC ¶61,230) or variable cost minimum bills under Order No. 380, but these concerns do not bear on the inherent nature of a unit power contract. Recasting GSU's objections to its capacity obligations in terms of "take-or-pay capacity" and "minimum energy purchase" provisions does not make these contracts unjust and unreasonable.

The LPSC likewise supports GSU's argument for broadening the scope of the "just and reasonable" standard beyond cost of service. The LPSC argues that the Commission must consider the purpose of the contracts and the benefits sought to be derived by the parties in order to determine if the contracts are presently unjust and unreasonable. It maintains that the stated purpose of the contracts was to provide GSU with lower cost displacement energy. The LPSC reasons that the lower cost displacement energy would allow for efficient utilization of resources, promote economy of power supply, and conserve generation of more expensive fuels. It contends that since the cost of power from Southern greatly exceeds GSU's own avoided costs, GSU is not realizing its expected energy savings. The LPSC concludes the purpose of the contracts, to provide lower cost displacement energy to GSU, is frustrated and continued enforcement of the contracts has become unjust and unreasonable.

The LPSC further argues that the contracts are unduly discriminatory or preferential. It states that the contracts for sale of capacity and energy from Southern to GSU were executed contemporaneously with Service Schedule G-ECON which provides for the sale of energy from GSU to Southern. The LPSC contends that these sales must be viewed as interrelated transactions, and as such, their effect is discriminatory against GSU because under the contracts, GSU pays $79/MWh of power while Southern pays only $20/MWh of power.

Southern defines "just and reasonable" to mean the seller's cost of providing the service in question, and it defines "unduly discriminatory or preferential" to describe the situation where the utility bills different charges to different customers for comparable services. Southern states that GSU's own witnesses have conceded that this is the traditional application of the operative language of Section 206(a). (Ex. G-77, p. 4.) Southern claims that having failed to satisfy the two inquires above, GSU is now attempting to create new, untenable legal standards. It describes GSU's "just and reasonable" standard as consisting of the seller's cost-of-service plus other cost and non-cost factors. Southern lists these factors as being: (1) GSU's financial condition; (2) "unforeseen changed circumstances"; (3) Southern's "lack of reliance" on the UPSA; (4) Southern's relative size; (5) Southern's need for the dedicated capacity; and (6) the disallowance by state regulatory agencies of pass-through of costs. Southern argues that questions concerning the economics or prudence of the transaction from the buyer's perspective are irrelevant to the determination of justness and reasonableness. Southern cities *Southern Company Services, Inc.*, 26 FERC ¶ 61,360 (1984), where the Commission held that allegations that GSU could buy power from other less costly sources were "irrelevant to this case because the Commission is not empowered to disapprove or modify a power sales agreement on the grounds that the buyer may not be making the best possible deal." *Id.* at p. 61,795.

Southern claims that the Commission has already rejected arguments identical to GSU's argument. It cites *Pennsylvania*

Power & Light Co., 23 FERC ¶ 61,006, *reh'g denied*, 23 FERC ¶ 61,325 (1983) as an example. Southern states that in *Pennsylvania Power*, the buyer claimed that its contract had become unjust and unreasonable due to factors such as the buyer's lack of need for the power, the availability of alternative sources of cheaper power, and the refusal by state commissions to allow the pass-through of costs. The Commission held that:

> The legislative purpose of the Federal Power Act is to ensure that the rates and terms of service for transmission and sales of electric energy subject to the jurisdiction of the Commission are just and reasonable. *We have made that public interest determination here by finding that PP&L's rates under the agreement are not excessive.*
>
> AC, Advocate and the Board do not argue that PP&L's rates are excessive, but that *the purchase is uneconomic from AC's point of view. We do not view our responsibilities under the Federal Power Act as including a determination that the purchaser has purchased wisely or has made the best deal available.*

23 FERC at p. 61,716 (emphasis added). Southern further notes that the Commission concluded that the availability of alternative power sources and the refusal of the state commissions to allow the pass-through of costs are irrelevant to the justness and reasonableness inquiry under Section 206(a).

Southern further cites *Pacific Power & Light Co.*, 27 FERC ¶ 61,080 (1984), as an example of a Commission decision rejecting expansion of the "just and reasonable" standard. Southern claims that in response to the buyer's claims that the "proposed Agreement is uneconomical, not competitive with other alternatives and will leave [the buyer] in an excess capacity situation," the Commission reaffirmed its holding in *Pennsylvania Power & Light* and held that the "prudence or feasibility of [the buyer's] capacity purchase" is extraneous to the determination of "whether the filed Agreement represents a reasonable basis for PP&L's charges for the service requested by [the buyer]." 27 FERC at p. 61,148. Southern also refers to *Philadelphia Electric Co.* 15 FERC ¶ 61,264 (1981), as additional authority on this point.

Southern argues that GSU's attempt to add factors beyond cost-of-service to the determination of justness and reasonableness should be rejected because of policy considerations. Southern cites the following language from *NAACP* v. *F.P.C.*, 425 U.S. 662 (1976):

> This Court's cases have consistently held that the use of the words "public interest" in a regulatory statute is not a broad license to promote the general public welfare. Rather, the words take meaning from the purposes of the regulatory legislation.

Id. at 669 (Footnotes omitted). Southern argues that in *Pennsylvania Power*, the Commission recognized that the public interest considerations underlying the Federal Power Act are not "company-specific" or regional, but are national in scope. Southern concludes, therefore, that the Commission should not allow state regulatory agencies to shift the loss from their regions to other regions by giving unfavorable retail rate treatment to purchasers' expenses.

Southern further argues that the preservation of the integrity of contracts is an important policy consideration in this proceeding. It asserts in its initial brief that the primacy of contracts must be upheld because they "play a vital role in encouraging the orderly development of plentiful supplies of electricity at reasonable prices." Southern cites the following passage from *Pennsylvania Power:*

> [W]e note that power supply arrangements are often negotiated on a long-term basis. It requires many years to build a generating plant and the building utility must be able to rely on long-term sales contracts in making its own capacity plans just as the purchasing utility must be able to rely on long-term contracts for stability of supply. Demand forecasts may change dramatically and quickly, as we have seen in recent years. The prudence of a sales arrangement, therefore, should be judged on the circumstances prevailing at the time such a contract is entered into. If a State commission, this Commission, or a utility itself could release a party to a contract from its contractual commitments simply because the contract, based on hindsight

> and demand forecasts in later years, no longer appears economical, the utility industry would have no supply stability or reliable basis for constructing [a] plant.

23 FERC at p. 61,019 (footnotes omitted).

The Commission more recently refused to sanction contract abrogation in *Tennessee Gas Pipeline Co.* v. *Pan-Canadian Petroleum Co.*, 38 FERC ¶ 61,236 (1987). There Tennessee Gas Pipeline Co. (Tennessee Gas) initiated an Emergency Gas Purchase Policy (EGPP) to unilaterally reduce its purchase and take-or-pay obligations for natural gas. The Commission refused to sanction the EGPP noting that, in Order No. 436, it had decided not to endorse "cut-back" plans as a means to reduce pipelines' liabilities under high cost gas contracts because to do so would undermine the integrity of contracts in the gas production industry. *See*, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, 50 Fed. Reg. 42,408 (Oct. 18, 1985), *FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,665. The Commission reasoned that the pipelines are ultimately responsible for and have the ability to manage their "problem contracts," and thus, there is no reason to undermine these contracts "by governmental fiat." The Commission further stated that the purpose of Order No. 451 is to give the utilities leverage to reduce their liability by providing for good faith, mutual negotiation procedures. The Commission clearly stated that Order No. 451 does not provide for the "unilateral abrogation of contracts."

Finally, Southern argues that under *F.P.C.* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942), the "just and reasonable" standard is equivalent to applicable Constitutional standards, and so the Constitutional prohibition against confiscation of property applies. Southern concludes that GSU's requested relief would deny Southern a return on its investment and thus, would constitute an impermissible confiscation of property under the Constitution.

In its brief, Oglethorpe fully supports Southern's position.

Staff states that the "just and reasonable" standard applies and that Southern's rates merely reflect its cost-of-service. Having established this, Staff addresses what it sees as the crux of the issue. It asserts that GSU, LPSC, and SRG&T offer essentially two grounds to justify shifting the costs from GSU to Southern: (1) the contracts require Southern to adjust the contract terms in view of changed economic conditions; and (2) the Commission should employ its authority under Section 206(a) of the Federal Power Act to abrogate the contracts since changed conditions have made the contracts financially burdensome and GSU's bankruptcy would not be in the public interest.

Staff submits that GSU fails to meet its burden in regard to either ground. First, it argues that the contract argument contradicts GSU's repeated admission in pre-filed testimony and at the hearing that Southern was not required to agree to any change in the contract terms. Second, Staff concludes that the Section 206(a) argument fails because GSU, LPSC, and SRG&T have not demonstrated how the public interest would be furthered by the Commission's assisting state regulatory agencies in shifting costs to another jurisdiction on the premise that the other utility and its consumers are better able to bear those costs. Staff argues that the Commission's obligation to promote the public interest must be considered in the context of the primary goal of the Federal Power Act, i.e., the orderly development of plentiful supplies of electricity at reasonable prices. The Staff refers to the *NAACP* case as authority for this proposition. Staff asserts that consequently, any action taken by the Commission under Section 206(a) due to public interest considerations must be evaluated as to its impact on all electric consumers as opposed to just those who are serviced by GSU. Evaluating the relief requested by GSU in this manner, Staff concludes that the harm which cost shifting would cause Southern, its customers, the financial structure of the electric industry, and consumers in general would so adversely affect the overall public interest that relief must be denied.

Though both GSU and SRG&T express their reliance upon the "just and reasonable" standard under Section 206(a), to the exclusion of the *Sierra-Mobile* public interest standard, they nevertheless make an argument that non-cost factors, which appear to entail general public interest considerations, should be considered along with cost factors in making the just and reasonable determination. These factors include: (1) unforeseen changed circumstances; (2) benefits and burdens; (3) GSU's financial condition; (4) the disallowance of pass-through by the PUCT and the LPSC; (5) Southern's lack of reliance on the UPSA; (6) Southern's need for the dedicated capacity; and (7) the relative size of Southern. They are discussed below and in succeeding sections as they relate to specific issues.

Unforeseen Changed Circumstances

GSU and SRG&T assert that the present non-cost factors upon which they rely are the result of "unforeseen changed circumstances," principally that GSU's load forecasts have declined resulting in excess capacity and a lack of need for Southern's capacity and that natural gas is available in great amounts and at lower prices.

Southern maintains that the "unforeseen changed circumstances" cited by GSU were known and foreseeable and were specifically addressed by the parties when the contracts were modified in 1983. It notes that the problems identified by GSU's Dr. Murrill during the course of the 1983 negotiations included: (1) falling natural gas prices and increased availability of natural gas; (2) the pending completion of the River Bend Nuclear Plant and anticipated state regulatory problems associated therewith; (3) the depressed economy in GSU's service areas; and (4) GSU's falling load forecasts, including a lack of need for the capacity. Southern asserts that the 1983 amendments to the UPSA were intended to address these problems. It points to the addition of Section 2.2.4 to the UPSA, which denies any future decreases in the amount of unit power capacity as a result of a change in Gulf States' avoided costs, as an indication

of the understanding between the parties that the risk associated with further reductions in natural gas prices was to be borne by GSU. Southern contends that the terms of UPSA do not state that the energy is being sold for its displacement value and that GSU's subjective motivations in entering into the agreement are irrelevant.

Southern's argument regarding the absence of GSU's cited "unforeseen changed circumstances" is persuasive. The problems which GSU faces, with one notable exception, were identified and addressed in the 1983 amendments to the UPSA. While there is some evidence that the severity of these problems has been exacerbated since 1983, the principal change, which has occurred since the implementation of these contracts and which may not have been foreseen, has been the refusal of the state regulatory commissions to permit GSU to recover the costs under these contracts and their refusal to grant rate relief for the River Bend Nuclear Plant. The impact of the state regulatory commissions' actions will be discussed in greater detail with regard to GSU's financial situation.

To the extent that the "unforeseen changed circumstances" argument is offered by GSU in support of a finding that the UPSA or Schedule E is unjust, unreasonable, unduly discriminatory or preferential or contrary to the public interest, it is rejected as these changed circumstances, with the exception of the state regulatory commissions' actions, were foreseeable and actually considered by parties and, in any event, it does not support GSU's position on the Section 206(a) issues.

Benefits and Burdens Under the Contracts

In support of GSU's plea that the contracts be modified or abrogated under Section 206(a) so as to discharge GSU from its obligations, both GSU and SRG&T take the position that the contracts are not producing the benefits that GSU expected and that were alluded to in prefatory language of the contracts. GSU and SRG&T invoke the continuing authority of the Commission under Section 206(a) and under provisions of the con-

tracts to ensure that the benefits which the parties expected when the contracts were entered into would continue to flow for the life of the contracts. Comparing its "avoided costs," in regard to energy alone, to the cost of capacity and energy under the contracts with Southern, GSU contends that it can now produce enough energy from its own units to meet its energy needs cheaper than the cost of power under the Southern contracts. GSU concludes that its contracts with Southern have lost their value as a source of displacement energy and, therefore, GSU should be released from its obligations to take and/or pay for capacity and energy under the UPSA and Schedule E. Additionally, GSU and SRG&T contend that, while GSU has "suffered severe financial loss," Southern has "enjoyed substantial entrepreneurial profits" above its cost of service.

The arguments of both GSU and SRG&T espousing an assured entitlement to perpetual contractual benefits are without merit. Though the prefatory language in the contracts does refer to certain intended benefits for both parties, neither the UPSA nor Schedule E provides any guarantee that such anticipated benefits would be fully, or even partially, realized throughout the life of the contracts. While the anticipated benefits undoubtedly appeared larger to GSU when it entered into the contracts in 1981-82, at a time that its 23§ per Mcf, 20-year gas contract with Exxon was about to expire and it could obtain lower cost coal generation, instead of sharply higher gas generation, the bulk of the benefits to GSU remain. In its initial brief, Southern summarized these benefits from GSU's own documents as follows:

> 1. The contracts with Southern Companies allowed Gulf States to defer a longer, more-costly commitment to construct or acquire ownership of new capacity. (Ex. S-117; Ex. S-108, p. 40; Tr. 166). Had Gulf States pursued the construction option, it would have incurred costs totalling approximately $626 million—even if the planned generation shown on expansion plan K-5 (Ex. S-46) had been cancelled by the end of 1983. (Shepard, Ex. S-44, pp. 9-11; Ex. S-48 and S-49.)

2. The cost of capacity and energy under the contracts with Southern Companies has proven to be lower than projected at the time Gulf States entered into those agreements. (Usry, Ex. S-39, pp. 23-24; Ex. S-40.) Had Gulf States pursued the only other viable purchased power option (Middle South's Grand Gulf Nuclear Unit), the cost would have been in the order of $125 per MWh. In comparison, the cost of Southern Companies' power (when utilized in accordance with the intended capacity factors) is approximately $47.75 per MWh over the remaining term of the contracts. (Shepard, Ex. S-44, pp. 15-16). Even Gulf States' analysis (utilizing extremely low capacity factors of approximately 45 percent) shows the cost of Southern Companies' power at approximately $79 per expected MWh (McLaughlin, Ex. G-30, p. 9)—far lower than the Grand Gulf alternative.

3. Gulf States diversified its primary fuel mix from a heavy dependence on natural gas, thereby protecting itself against volatile natural gas prices and potential unavailability of supply. (Ex. S-108, p. 40.) This need to diversify was heightened by the impending expiration of the natural gas contract with Exxon, which was providing approximately 55 percent of its natural gas requirements and was due to expire at the end of 1984. (Naylor, Ex. G-9, pp. 3-4; Ex. S-117, p. 4.) Because of the contracts with Southern Companies, Gulf States was able to maximize its utilization of its low-cost Exxon gas, producing "enormous" savings to its ratepayers. (Ex. S-109, p. 10.)

5. Gulf States established its first interconnection with Southern Companies, thereby ending what it characterized as the Middle South "bottleneck." (Ex. S-33, p. 5.) This interconnection was a direct consequence of the UPS Agreement, without which the interconnection could not have been economically justified from Southern Companies' perspective. (Ex. S-32, p. 5, ¶ 9; Usry, Ex. S-29, pp. 8-9.) The continuing benefits to Gulf States from the interconnection include enhanced reliability, access to purchased power markets (both as a buyer and as a seller) and increased leverage in dealing with fuel suppliers. (Ex. S-108, p. 40.) Southern Companies did not benefit as did Gulf States from the interconnection of the two systems. (Ex. S-109, pp. 52-53; Shepard, Ex. S-44, pp. 23-25.)

There has been no showing that these benefits will not continue in the future or even increase if natural gas prices should escalate. GSU and SRG&T's novel "continuing benefits" concept provides no support for its claim of relief under the standards of Section 206(a).

The burdens which GSU and SRG&T refer to result in large measure from GSU's improper comparison of its avoided energy costs to the capacity and energy costs of Southern. The flaw in GSU's argument is easily illustrated by assuming that rather than purchase a block of unit power from Southern, GSU had built its own 1,000-MW coal-fired unit on its system. Under those circumstances, GSU would have been obligated to incur both capacity and energy costs. The comparison of such capacity and energy costs to the capacity and energy costs of Southern would provide a true comparison of relative costs. The difference of costs under a comparison with GSU's existing coal plant actually favors Southern. Moreover, when Southern's unit power costs are compared to GSU's costs for the River Bend Nuclear Plant or the Cajun Electric Power Cooperative, Inc. buy-back of River Bend capacity, they appear relatively modest.

GSU further contends that to date the UPSA and Schedule E have resulted in a financial loss for GSU and a windfall for Southern. GSU more specifically asserts that: (1) Southern has already recovered through the UPSA and the Interchange Contract benefits exceeding both its actual costs and its full traditional cost-of-service; (2) GSU has already incurred a loss of about $279 million; (3) GSU will pay an additional $630 million in charges for capacity for which it has absolutely no need; (4) GSU will lose an additional $63 million in contractually mandated energy purchases; (5) Southern will receive all of the benefits it had sought if these contracts continue unaltered; (6) Southern has received, or will accrue, $363 million of capacity charges by May 31, 1987 and an additional $630 million of capacity charges if the contracts continue unaltered; (7) Southern saved at least $526 million in reduced

plant costs by relying on the contracts and maintaining its construction schedule; and (8) adding the $363 million of capacity charges through May 31, 1987 and the $526 million in reduced costs and classifying the total of $889 million as a benefit to Southern, and then comparing that total with the total UPS capacity charges of $738 million, GSU calculates Southern's net gain to be over $150 million.

In making these assertions, GSU relies upon the testimony of witness Mozer (Exhibits G-91 and G-94). Mr. Mozer estimated the benefits and costs each party has received, or will receive, as a result of the UPSA. In doing so, he assumed that Southern relied on the UPSA to continue construction of the 10 units and did not defer capacity related to these units. Mr. Mozer then detailed the benefits and losses that each party will have incurred under the agreements from the signing of the UPSA to May 1987 and calculated additional benefits and losses from June 1987 to the end of the contract terms. The additional benefits were broken down into two categories:

> (a) benefits/losses that would occur if there is no change in the present form of the contracts over the remainder of the contract period;
>
> (b) benefits/losses that would occur if the contracts were modified as suggested by Mr. Louiselle. Mr. Louiselle's recommendation would require Southern to reduce the capacity charges to zero and to require the energy to be made available at or below Gulf States' avoided costs.

Ex. G-72, pp. 35-36. In his calculations, Mr. Mozer assumed that the Schedule E capacity payments are a benefit to Southern because Southern did not have to build additional capacity to support Schedule E sales. As for Mr. Mozer's approach, the Commission has specifically declined to engage in evaluations of the relative economic benefits of contractual arrangements. *Pennsylvania Power & Light Company*, 23 FERC ¶ 61,325, at p. 61,716 (1983). Even if the Commission were to depart from this precedent, Mr. Mozer's method can be given little weight since the testimony and exhibits sponsored by him do not

accurately portray the benefits and costs each party has received, or will receive, as a result of the UPSA. In fact, he conceded that he did not quantify all the benefits (Tr. 684). Consequently, GSU's position regarding benefits and costs is rejected.

Mr. Mozer's Exhibit G-94 inaccurately portrays benefits and costs because: (1) it assumes that the GSU capacity payments were paid to Southern; (2) it fails to reflect the benefit to GSU and the cost to Southern of $350-$400 million from the amendment to reduce UPS capacity charges and implement the lower cost Schedule E capacity charges; (3) it assumes that the Schedule E capacity charges are a net benefit to Southern even though Southern constructed the higher cost UPS units and voluntarily decreased the capacity charge to the lower Schedule E charge; and (4) it fails to reflect the cost savings of $300-$600 million to GSU from entering into the UPSA and not constructing additional generating capacity of its own and/or not converting its own existing generating capacity.

Exhibit G-94 shows capacity costs for the UPSA and Schedule E of $993 million for the life of the contracts. It further shows that Southern saved $526 million on the construction of the plants and assumes that the total savings are attributable to the UPSA with GSU, and not the UPSAs with FP&L or JEA. That exhibit also shows capacity payments to Southern of $363 million through May 1987. Adding the $363 million capacity charges, even though some of this has not been actually paid by GSU to Southern, to the $526 million benefit, which Mr. Mozer attributes entirely to the GSU UPSA, yields an amount of $889 million. Even if one accepted Mr. Mozer's characterization of the benefits to Southern, it is not greater than the $993 million of capacity charges shown on Exhibit G-94. Thus, Mr. Mozer's conclusion that Southern has already received more benefits than the total capacity charges is unfounded. Moreover, GSU has not paid and Southern has not received the entire $363 million of capacity payments which Mr. Mozer has listed as payments.

GSU alleges that it has already incurred a loss of $279 million, but Mr. Mozer fails to consider the benefit of the $300-$600 million already received by GSU as a result of not having to construct additional generating facilities during this same time period.

GSU may incur an additional $630 million cost related to capacity after June 1987 due to capacity charges billable in accordance with the contracts. It is found that Southern is not receiving a windfall but merely reimbursement of its costs as allowed by the UPSA and Schedule E of the Interchange Contract. GSU witness Naylor has regularly checked the invoices for payment and has verified that they are in accordance with the formulary rate (TR. 1773).

As for the additional $63 million cost for contractually mandated energy purchases, GSU may have to expend that amount if its gas power generation continues to be cheaper than Southern's coal-generated energy. The relationship between GSU's gas power generation and Southern's coal-fired generation depends primarily on the extremely volatile price of natural gas. Even GSU admits that this projected gas energy benefit could very quickly become a burden should the price of natural gas increase. (Tr. 143-144; Ex. G-32.) The energy costs under the UPSA and Schedule E would, however, be offset by the Schedule R purchases.

Correcting Mr. Mozer's exhibit: (1) to reflect all capacity charges as a cost of the UPSA; (2) to reflect a $300-$626 million cost savings to Gulf States for not having to construct, or modify, a generating plant since 1982; (3) to allocate to GSU only a portion of the cost savings benefit from Southern's ability to continue to maintain its construction schedule; (4) to reflect the fact that the capacity charges represent a cost to Southern of providing GSU with capacity from these units; and (5) to incorporate other economic benefits received by GSU such as fuel diversity and increased bargaining power with its fuel suppliers, drastically changes the benefit and loss amounts calculated by Mr. Mozer and relied on by GSU. The corrected

Mozer exhibit reflects benefits to both parties through May 1987 and if the contracts remain intact, through the entire contract term. The contract modification proposed by GSU and SRG&T, on the other hand, would impose a significant cost upon Southern and a major benefit to GSU from May 1987 until the end of the contract period.

Southern and Staff state that Southern has invested in excess of $1.4 billion since 1982 in the units from which GSU unit power sales are made. It is noted that these costs were not expended solely to provide the 1,000 MW of capacity originally contracted for by GSU pursuant to the UPSA, but were expended to also meet the 2,000 to 2,500 MW of unit power contracted for by FP&L and JEA (Ex. S-42, p. 9) and to supply Southern's own load requirements in the 1990's. These investments represent actual costs incurred by Southern. The UPSA does not require that GSU and/or FP&L or JEA reimburse Southern for these $1.4 billion in investment costs. GSU is, however, contractually obligated pursuant to the UPSA and the Interchange Contract to pay capacity charges to Southern. These capacity charges are calculated in accordance with the formulary rate found in the Unit Power Sales Manual (UPSM), which was agreed to by both GSU and Southern. The UPSM details that GSU will be billed for capacity charges which include costs related to depreciation of the investment in the units, a return on investment in the units, taxes related to the units and operation and maintenance of the units. GSU is not billed for total capacity charges for these units but only for its share of the contracted capacity. FP&L and JEA are also billed for their share of the contracted capacity from these same units. In the 1990's, when the UPSA's have expired, Southern customers will be billed for the capacity charges related to these same 10 units. Southern's customers will be paying for depreciation, return on investment, taxes, and operation and maintenance costs for these units.

GSU incorrectly states that the sole beneficiaries of the capacity from these 10 units will be Southern's future customers and that they will pay a billion dollars less than the true cost

of the units. Southern is billing GSU, FP&L and JEA for their respective shares of the capacity charges, i.e., for the portion of UPS capacity each contracted for during the respective periods. Southern's future customers will be fully billed for their share of the capacity charges. GSU's allegations mischaracterize the capacity charges by equating them to the cost to complete the plants or to the excess investment costs required to complete the plant. Southern's capacity is billed in accordance with the contracts and properly compensates Southern for its contractual obligation to provide capacity to GSU.

GSU's contentions regarding the expected benefits and burdens under the UPSA and Schedule E are not meritorious and have not been shown to support GSU's claim for relief pursuant to the "just and reasonable" standard or any public interest considerations under Section 206(a).

GSU's Financial Condition

In support of its request for relief under Section 206(a), GSU refers, at several points in its brief, to the substantial financial loss that it has incurred as a result of the contracts. In describing its present financial condition, GSU indicates that it is extremely weak and that it is teetering on the brink of bankruptcy. GSU further states that it had no cash earnings in 1986 and faces a cash deficit of about $410,000,000, exclusive of any capacity payments to Southern. In the absence of adequate rate relief and assuming no capacity payments to Southern, it states that its cash deficits will rise from $450,000,000 to $500,000,000 annually in 1988 and 1989. GSU states that it has not paid dividends on its common stock since the second quarter of 1986 and that it stopped paying dividends on its preferred and preference stock in the first quarter of 1987. GSU also notes that its ability to access the capital markets on reasonable terms is questionable. In sum, GSU indicates that its financial situation is poor and its ability to serve the public is in serious jeopardy.

In responding to GSU's allegations that the contracts with Southern are the cause for GSU's admittedly poor financial

condition, Southern states that GSU has failed to adduce any evidence to show that: (1) the contracts with Southern are the direct and proximate cause of its present financial situation; and (2) that the action requested of this Commission will cure the financial problems being experienced by GSU.

In support of its argument that the contracts are not the cause of GSU's current cash problem, Southern makes the following points:

> (i) Since July 1986, Gulf States has made no capacity payments to Southern Companies under the contracts, but did make capacity payments into the Registry of the federal district court. This is true although Gulf States was collecting capacity payments under the contracts from its retail ratepayers in Louisiana and from its wholesale customers subject to FERC jurisdiction.
>
> (ii) Beginning in July 1986, Gulf States paid to Southern Companies only a portion of the energy charges under the contracts representing Gulf States' "avoided costs," with the balance of the energy charges paid into the Registry of the federal district court. At all times, Gulf States has been permitted to collect from retail and wholesale customers the energy charges otherwise due under the contracts (Tr. 359-367.)
>
> (iii) After the PUCT and LPSC disallowed collection from retail ratepayers of capacity charges under the contracts in October and November of 1986, Gulf States paid neither Southern Companies nor the Registry of the federal district court any capacity charges associated with its retail jurisdictions. Gulf States did continue to pay into the Registry those capacity charges under the contracts associated with its wholesale business regulated by this Commission.
>
> (iv) Beginning in February 1987, Gulf States only paid to Southern Companies a portion of the energy charges due under the contracts representing its "avoided cost" of energy. At this time, Gulf States discontinued paying any amounts into the Registry of the district court. Although only paying a portion of the energy costs to Southern Companies, Gulf States continued to collect all energy

charges from retail ratepayers in Louisiana and Texas and all energy and capacity charges from wholesale customers. (Tr. 343-370.)

Southern points out that rather than imposing a financial burden, GSU's present collections of capacity charges from its own customers, and its limited payments to Southern, cause the contracts to be net revenue producers for GSU. It notes that in 1986 Southern offered to defer GSU's payments under the contracts in an attempt to help GSU solve its cash-flow problems and to give it the "breathing room" which GSU states it so desperately needs, but GSU rejected the proposal. Southern argues that the root cause of GSU's financial problems is not its obligations under the UPSA or Schedule E but rather its inability to obtain retail rate relief from the state regulatory commissions for its River Bend Nuclear Plant, which in 1987 will impose a cost of about $900 million upon GSU.

During Southern's cross-examination of Gulf States' witness, Mr. Donnelly, it was established that GSU will have the following costs and expenses associated with the River Bend Nuclear Unit in 1987:

Description of Cost or Expense	*Dollar Amount (Rounded)*
Carrying costs of GSU's investment in River Bend	$490 million
Depreciation expense associated with GSU's investment in River Bend	89 million
Decommissioning expense associated with River Bend	3 million
Buyback expense associated with purchase of Cajun ownership of River Bend	174 million
Nuclear fuel for River Bend	46 million
Additional construction expenditures associated with River Bend	23 million
O&M expenses related to River Bend	68 million
Total Expenses	$893 million

(Tr. 442-447)

The record indicates that GSU is currently not recovering any of these costs and expenses as a result of the state commission's failure to permit such recovery from the retail ratepayers.

Southern maintains that the almost $900,000,000 of annual carrying costs and expenses for the River Bend Nuclear Plant are the basic cause of GSU's financial distress and that these costs and expenses dwarf the $132,000,000 of capacity charges which GSU owes Southern. Southern asserts that it is the state regulatory commissions that will decide GSU's fate. It notes that this Commission has already allowed GSU to recover from its wholesale customers the costs associated with River Bend Nuclear Plant.

In analyzing GSU's future financial condition, Southern refers to a three-step rate moderation plan which GSU filed with the PUCT and the LPSC. Under that plan, GSU requests a 25 percent increase in its retail rates effective in mid-1987, a 13 percent increase effective mid-1988, and a 7 percent increase effective in mid-1989. Although Southern recognizes that these increases are significant, it maintains that these increases are not out of line with increases which state public utilities commissions have granted other utilities which have put new nuclear units into service. Moreover, Southern points out that the proposed retail rate increases appear even less onerous in light of the fact that GSU's retail rates have decreased approximately 20 percent in the last 18 months. Southern shows that under GSU's proposed rate moderation plan, GSU would experience a very rapid recovery in its financial condition with return on common equity rising to over 12 percent in 1987 and to almost 15 percent in 1989 and 1990. Southern further demonstrates that GSU's internal generation of funds (as a percentage of construction expense excluding AFUDC) would improve from a negative 61.6 percent in 1986 to a positive 627 percent in 1990. If GSU is successful in obtaining its rate moderation plan, it will be the beneficiary of a strong cash flow with net internal cash generation at $918,000,000 by 1990. Under its plan, GSU could voluntarily

retire $520,000,000 of debt and preferred stock in 1989 and $492,000,000 in 1990. In addition, it could retire $200,000,000 of common stock in 1990. Southern concludes that, even with these transactions, GSU would reach a common equity ratio of 60 percent, which far exceeds the industry average of 41 percent.

Southern maintains that the financial results shown in the rate moderation plan are extremely conservative and do not include payment of capacity charges to it. Southern, consequently, performed a study which demonstrates the financial results to GSU of the rate moderation plan assuming payment of capacity charges to Southern, but with no additional revenue. Southern's study shows that GSU can make capacity payments to Southern and remain financially viable without any revenues over the amount requested in the rate moderation plan for the River Bend Nuclear Plant. Southern also performed a study analyzing the financial impact of the rate moderation plan on GSU assuming payment of capacity related charges to Southern and a one-third disallowance of the investment by GSU in the River Bend Nuclear Plant. Even under this scenario, Southern asserts that GSU would be able to pay Southern for the capacity under the contracts and be in a positive cash generating position after 1987.

To rebut Southern's testimony, GSU's Witness McBride describes a scenario where GSU only obtains approximately one-half the rate increases it seeks in its rate moderation plan. McBride attempts to demonstrate that under these circumstances, GSU would be unable to make the capacity payments to Southern without undue financial hardship. On cross-examination, however, Mr. McBride conceded that he did not believe GSU could survive with only 50 percent of the rate increases requested. Southern submits that if GSU could not survive under the 50 percent assumption, then it makes no difference whether or not GSU could pay Southern.

In its brief, Staff argues that the evidence does not support a finding that the UPSA and Schedule E charges impair GSU's

financial ability to continue its service. Staff, like Southern, contends that the crux of GSU's financial problem appears to be the company's investment in the River Bend Nuclear Plant, pointing out that since River Bend went into operation in the summer of 1986, GSU has yet to receive any permanent rate relief from the state public utilities commissions. Staff also notes that the carrying costs and other costs associated with River Bend for 1987, totalling almost $900,000,000, is substantially less than the capacity payment which GSU owes Southern and which GSU is not currently paying. Staff points out that GSU needs $410,000,000 in rate relief to cover its operating costs, but its capacity payments to Southern, if such payments were being made, only total $134,000,000. Staff asserts that even if the contracts were abrogated GSU would still face a deficit of $276,000,000. Thus, Staff contends that Commission abrogation of these contracts would not guarantee GSU's financial solvency; it would instead leave Southern without any standing to collect on the contract debt, if GSU went into bankruptcy.

The evidence in the record overwhelmingly establishes that the principal cause of GSU's current financial difficulties is the failure of the state regulatory commissions to provide rate relief in connection with the River Bend Nuclear Plant, which went into operation in the summer of 1986. Since GSU currently is not making payments for UPSA or Schedule E capacity, any proposed modification of the contracts would not relieve GSU's cash-flow problem, even if it were entitled to such relief under Section 206(a) in the first instance. Moreover, there has been no showing that Commission action with respect to the contracts would ensure the continuation of reliable service under the circumstances presented.

GSU, through its witness Donnelly, asserts further that the continuation of the purchases under the contract could force GSU's rates to levels substantially in excess of the level of competitive rates within the service area. In rebutting this allegation, Southern has shown that GSU's rates under its rate moderation plan would be competitive.

GSU's evidence of financial hardship does not support its contention that the contracts herein are unjust, unreasonable, unduly discriminatory or preferential, or contrary to the public interest.

Southern's Comparative Size

GSU argues that consideration of the relative impact of the capacity upon Southern and upon GSU is appropriate and relevant. It contends that due to Southern's larger size, Southern sales were approximately 99 billion kWh in 1985 (Ex. G-110 at p. 3) whereas GSU's were approximately 29 billion kWh (Ex. G-70) at p. 4), and with better financial health, Southern is better able to sustain the loss associated with the UPSA and Schedule E. GSU argues that termination of the contracts would cost Southern only 26¢-35¢ a share in earnings from 1987 to 1990. If no rate relief is forthcoming from the state commissions, GSU claims that payment of the capacity charges would force the utility into bankruptcy. GSU further argues that even if the state commissions accept its rate moderation plan, it may not be able to resume payment of common stock dividends until 1990.

Southern does not dispute GSU's assertion that the Southern system is far larger than the GSU system, but it does refute GSU's claim that the impact of absorbing the capacity at issue would be much less damaging to Southern than GSU. Southern asserts that it will have no need for the capacity during the term of the contracts, that its service area includes one of the poorest states in the country, and that it may soon encounter the same problems which GSU is now experiencing with River Bend when Southern's $8.4 billion Vogtle Nuclear Plant goes into service. In addition, Southern argues that GSU's "big versus little" argument has "no place in the American legal system" as the relative size of the litigants is not a legitimate consideration where the contract at issue was freely negotiated at arm's length by two commercial entities. Finally, Southern argues that the same amount of dollars will be expended whether they are paid by GSU or absorbed as a loss

by Southern, and thus, the real issue is who will pay. Southern maintains that it would be poor policy and bad precedent for this Commission to assign the loss from one region of the country to another based upon its determination that one is better able to afford the loss.

Staff acknowledges that allocating the costs of the contract to Southern would cause a much smaller percentage impact on Southern than it would on GSU, but it states that this is simply because Southern is a much larger system than GSU. Staff dismisses the relevance of the parties' comparative size by concluding that GSU is ignoring "the fact that one billion dollars is one billion dollars" and that "one billion dollars is a lot of money regardless of the size of the system."

Southern is indisputably a larger system than GSU but this is irrelevant to a consideration of the 206(a) issues. Southern is correct that the relative size of the litigants is not a legitimate consideration where the contracts at issue were freely negotiated at arm's length by two commercial entities. The mere fact that Southern is larger does not establish that Southern would be any less damaged by the assumption of the capacity at issue than GSU would be, even if it were found that GSU was entitled to relief. In addition, it would not be desirable, as a matter of Commission policy, to favor one utility over another or to favor one region over another based upon the utilities' comparative sizes or a determination of relative need.

GSU's comparative size contentions do not lend support to its position on the Section 206(a) issues.

Equitable Considerations

SRG&T further argues that equitable considerations confirm that the contracts fail the Section 206(a) test. It cites certain equitable considerations which are discussed herein with regard to non-cost factors in support of its argument, concluding that "under present circumstances it would be unjust, unreasonable and inequitable to require Gulf States to continue to bear the economic burden of take-or-pay capacity

charges in excess of avoided cost." SRG&T cites *Niagara Mohawk Power Corp.* v. *F.P.C.*, 379 F.2d 153 (D.C. Cir. 1967) in support of its addition of an equitable standard in the determination of what is just and reasonable under Section 206(a). *Niagara Mohawk* is a hydroelectric licensing case under the Federal Power Act wherein there was a challenge to the Commission's authority to assign an effective date earlier than the date of the issuance of the license when the project involved was one constructed or maintained without a license in violation of applicable law. Though not specifically authorized by the Federal Power Act, the court found the Commission's action in assigning an earlier effective date to be fair and reasonable and within its discretion. SRG&T's argument and cited authority does not suffice to enlarge the well-established standards of Section 206(a) as it suggests.

Upon consideration of the evidence and legal arguments, presented by GSU, and the supporting intervenors, as to Issues 1 and 2, it is concluded that GSU has failed to meet its burden of showing that the rates and charges under the UPSA and Schedule E of the Interchange Contract or the contractual provisions therein affecting such rates and charges are unjust, unreasonable, unduly discriminatory or preferential or contrary to public interest under Section 206(a) of the Federal Power Act. The evidence and legal arguments on these issues presented by Southern and Staff are entirely persuasive.

The attempt by GSU and SRG&T to show that the transaction embodied by the UPSA is something other than a unit power sale, as that term is known and commonly understood in the industry, and their attempt to show that GSU's obligations under the UPSA are tied to GSU's avoided costs are completely defeated by the terms of the UPSA and the parties' intent at the time the contracts were executed, as manifested by the evidence. Neither the expansion of capacity under the UPSA to 1,000 MW nor the later addition of Schedule E to the Interchange Contract changed the fundamental nature of the original unit power purchase. The record establishes that Southern is fulfilling its obligations under the contracts, that the charges

are cost-based and that the charges under the contracts are not unjust, unreasonable, unduly discriminatory or preferential, in any respect. Moreover, GSU and its supporting intervenors have failed to show that either the rates and charges or the terms affecting them under the UPSA and Schedule E of the Interchange Contract are contrary to the public interest.

Although GSU stresses its financial difficulties, GSU has not demonstrated that the contracts at issue are the proximate cause of those difficulties, nor has it shown that the contracts will impair its ability to provide service. The record reveals that GSU's financial difficulties primarily stem from the state regulatory commissions' failure to provide appropriate rate relief in connection with the River Bend Nuclear Plant.

Neither GSU nor its supporting intervenors has offered any precedent for the proposition that, under circumstances such as these, the public interest requires a purchaser to be relieved of its contractual obligations on the basis of non-cost factors. On the contrary, GSU's requested relief, which is tantamount to contract abrogation, and the theories upon which GSU rests its claim are fraught with negative public interest implications. Permitting contract abrogation in the circumstances herein would undermine the sanctity of contracts and in doing so, would create contractual instability in the electric utility industry. Furthermore, it would establish the precedent for Commission examination of all purchasers' financial circumstances in regard to any rate schedule or contract filed with the Commission. Thus, even if the contracts herein did adversely impact the public interest, which they do not, the greater public interest in maintaining the stability and integrity of electric utility contracts would far outweigh GSU's perceived public interest. Accordingly, it is concluded that no basis has been shown for the grant of relief requested by GSU under any of the well-established standards of Section 206(a).

Many of the non-cost factors which were introduced by GSU in support of its claim for relief, such as Southern's reliance upon the UPSA, Southern's ability to absorb capacity, South-

ern's load forecast, and the Southern system's greater size and financial stability, have been considered in relation to the public interest implications. However, they go to the issue of relief and do nothing to establish the grounds for granting relief under Section 206(a).

In light of the determination on the Section 206(a) issues above, certain specified issues relating generally to matters of relief or to alternatives and their impact upon Southern, need not be reached. In the interest of addressing all of the issues raised by the parties, however, these issues are discussed below.

Section 2.2.1

Issue 3: In light of Section 2.2.1 of the Unit Power Sales Agreement, when considered in the context of the overall contractual arrangement, should Gulf States be relieved of part or all of its purchase obligation under the Unit Power Sales Agreement?

Issue 4: If it is determined that Section 2.2.1 of the Unit Power Sales Agreement is applicable to Schedule E of the Interchange Agreement, then in light of Section 2.2.1 of the Unit Power Sales Agreement, when considered in the context of the overall contractual agreement, should Gulf States be relieved of part or all of its purchase obligation under Schedule E of the Interchange Agreement?

Issue 5: What is the meaning of Section 2.2.1 of the Unit Power Sales Agreement, and what are the reasonable alternatives available thereunder?

Issue 6: Whether the Commission should require Gulf States and Southern Companies to proceed under one of the reasonable alternatives?

Section 2.2.1 of the UPSA reads as follows:

> In the event either party desires to increase or decrease capacity sales or purchases for the years set forth above, the parties agree to negotiate in good faith and with dili-

> gence to proceed to evaluate alternatives which may reasonably provide for such desired change in capacity; provided, that no such change shall be made except upon mutual written agreement of the parties hereto.

GSU asserts that the intent of Section 2.2.1 is clear from the UPSA language immediately preceding it which "recognizes that long-range plans and forecasts which provide the basis for such sales and purchases of capacity are affected by many factors." GSU believes that the purpose of Section 2.2.1 is to keep unforeseeable changes in circumstances from undermining "the basis for such sales and purchases." It maintains that each party has the obligation to negotiate changes within the framework of restoring the basis for such sales and purchases of capacity if changed factors have destroyed that basis.

Southern devotes a significant portion of its brief to a discussion of Section 2.2.1. Beyond its acceptance of the plain meaning of that section, Southern contends that Section 2.2.1 constitutes an unenforceable agreement to negotiate which imposes no binding obligation on either party. Southern maintains that Section 2.2.1 requires mutual agreement on future changes in capacity under the UPSA but that the essential elements of this future agreement can never be ascertained by any reviewing tribunal. It argues that since Section 2.2.1 is at best an agreement to negotiate with no obligation to agree, it is impossible to determine the effect of a breach of its terms. Moreover, interpreting Section 2.2.1 in the manner suggested by GSU, Southern argues, would place the Commission, or another tribunal, in the role of supervisor of negotiations. Additionally, Southern asserts that Section 2.2.1 does not apply to Schedule E.

Southern further asserts that the addition of Section 2.2.4 in 1983 to the UPSA has a material bearing on the meaning of Section 2.2.1. Section 2.2.4 provides a means by which the amount of UPS capacity to be purchased by GSU can be unilaterally increased by Southern in response to increases in GSU's avoided costs, but it cannot be decreased. Southern argues that the language proscribing decreases of UPS capac-

ity imposes a limitation upon its obligation to negotiate capacity reductions under Section 2.2.1.

Southern states that it has been willing to negotiate alternatives with GSU in accordance with Section 2.2.1 and reiterates its willingness to terminate the present controversy on the basis of an alternative described by Mr. Franklin (Tr. 2577-2579) and summarized as follows:

> —The terms of the contracts would be enforced without additional change except as hereafter set forth.
>
> —Southern Companies would agree to negotiate an appropriate reduction in the level of return on equity provided by the contracts.
>
> —Southern Companies would agree that Gulf States may suspend its UPS and Schedule E capacity payments for such period of time as the Commission deems appropriate, thereby giving Gulf States the "breathing room" described by Dr. Murrill.
>
> —Southern Companies would only ask that Gulf States provide whatever security it can, acknowledging that Gulf States' ability to provide such security could have practical limitations.
>
> —Gulf States would be required to pay for energy on a current basis in accordance with the terms of the contracts.
>
> —All funds which have been paid into the Registry of the district court by Gulf States would be immediately released to Southern Companies.
>
> —When Gulf States resumes making capacity payments, it would also begin paying periodic installments to satisfy the accrued, but unpaid, capacity payments, together with reasonable interest thereon.
>
> —The foregoing resolution would constitute a settlement and termination of all pending legal actions relating to this dispute.

Southern urges the Commission to advise the parties that Mr. Franklin's proposal is reasonable and that GSU should be encouraged to accept it.

Southern notes that it has made prior concessions to GSU under Section 2.2.1, whereby the original 1,000-MW UPSA was modified to add Schedule E and to reduce UPS capacity at a cost to Southern of approximately $350-400 million, and substantially more if fuel related costs are considered. Moreover, Southern states that in the summer of 1985, it unilaterally offered GSU the opportunity to purchase lower cost energy under Schedule R in substitution for higher cost energy under the UPSA. By asking the Commission to allow Schedule R to become effective retroactively, Southern secured a $360,000 refund for GSU. Southern reports that Schedule R saved GSU approximately $20 million from August 1985 to December 1986 and that GSU has continued its takes under Schedule R in 1987 at very high levels.

In the spring of 1986, Southern states that it conducted extensive negotiations with GSU at GSU's request. Southern indicates that GSU initially sought the elimination, or suspension, of capacity sales and purchases under the UPSA pursuant to Section 2.2.1 at a potential cost to Southern of approximately $900 million. GSU subsequently made two other proposals: (1) the conversion of all UPS capacity purchases to Schedule E and (2) the elimination of GSU's capacity purchase obligations for the next three years with the additions such obligations to the end of the contract term. Southern contends that both of the proposals would have been very costly for it.

During the course of negotiations, Southern offered to postpone GSU's obligation for capacity purchases, if GSU would post acceptable security for this forbearance. GSU rejected this proposal. During that period, GSU did negotiate an arrangement with Cajun Electric Cooperative, Inc. with respect to the Cajun buy-backs which was not unlike the Southern proposal. The record shows that GSU agreed to spread the Cajun buy-back payments over five years rather than the original three years. This had the effect of reducing GSU's cash requirements in the latter half of 1986 and through all of 1987, by about $100 million, thus helping GSU with its cash flow position. Tr. 451. Southern asserts that GSU's alternative in

this proceeding as advanced by Mr. Louiselle is far worse than its earlier proposals, as it seeks the complete abrogation of the contracts. Mr. Louiselle's proposal is set forth below:

> At the very least, the capacity charges under both the UPS Agreement and Schedule E should be reduced to zero at the present time. Gulf States' obligation to buy energy under the UPS Agreement . . . should also be limited . . . To be specific, Gulf States should be required to buy energy from Southern to the extent that it has a price equal to or lower than the incremental cost to Gulf States of utilizing its own generating capacity . . . I recommend that the agreements be amended to require Gulf States to purchase the energy made available by Southern up to the contractual limits, at a price at or below Gulf States' avoided cost. Since Southern's energy cost at this time apparently exceeds Gulf States' avoided cost, the capacity charges would be zero at the present time. If Gulf States' avoided costs were to increase, Southern could again recover capacity charges such that the total price did not exceed that avoided cost (Ex. G-72, pp. 35-36).

Staff maintains that Section 2.2.1 does not require modification of the UPSA or Schedule E. Its position is that, while Section 2.2.1 does not require Southern to agree to a contract modification, it does require that the parties negotiate in good faith. Staff refutes GSU's contention that Southern has refused to negotiate in good faith to modify the capacity commitments under the UPSA and Schedule E. It argues that Section 2.2.4 applies to Section 2.2.1, thereby modifying Southern's obligation to negotiate by specifying that "in no event" shall the amount of capacity be "decreased." Staff argues that despite the fact that Southern was no longer contractually obligated to negotiate a decrease in capacity, Southern did comply with Section 2.2.1 by attempting to find a solution that would allow GSU to continue performance under the contracts while providing relief from its financial predicament.

The meaning of Section 2.2.1 is clearly discernable from the plain language of Section 2.2.1. Recognizing that the long range plans and forecasts, which provided the basis for the sale and purchase of capacity under the UPSA, may be affected by

many factors, GSU and Southern agreed to negotiate in *good faith* and *with diligence* as to future increases or decreases in capacity and that any such change would be made only upon the mutual written agreement of the parties. Southern's contention that this provision is unenforceable is not well founded. While it does not compel the parties to agree, Section 2.2.1 does impose an obligation upon the parties to negotiate in good faith and with diligence. Enforcement of this contractual provision by a court would rest upon the determination of whether the parties negotiated in good faith and with diligence. Failure to negotiate in good faith and with diligence would constitute a breach of a contractual obligation for which a court could fashion a remedy. The good faith issue was not litigated herein as the Commission's order left the good faith determination to the Federal District Court. Although the parties did not address the good faith issue, there is ample evidence in the record that the parties have engaged in meaningful negotiations since they initially entered into the contracts and that Southern was reasonably forthcoming in the most recent negotiations, i.e., from early 1986 until GSU initiated its suit in Federal District Court.

Southern and Staff's contention that Section 2.2.4 of the UPSA limits the operation of Section 2.2.1, by providing that UPS quantities will in no event be decreased under the formula prescribed in Section 2.2.4, is not well founded. Section 2.2.4 was adopted in the 1983 amendment of the UPSA. It provides for a formula which automatically decreases the amount of Schedule E power and automatically increases the amount of UPS power as GSU's avoided costs increase. This determination is made annually, in accordance with the terms of Section 2.2.4. Section 2.2.4 imposes no limitation on Section 2.2.1. The fact that the parties retained Section 2.2.1 in its original form when they adopted Section 2.2.4 demonstrates that Section 2.2.1 was intended to be independent of Section 2.2.4. It is found that Section 2.2.4, which prescribes a formula that automatically adjusts the mix of capacity obligations between the UPSA and Schedule E, does not in any way restrict what new

arrangement the parties may choose to mutually agree upon under Section 2.2.1. Thus, the obligation imposed by Section 2.2.1 to negotiate in good faith and with diligence as to changes in capacity under the UPSA is not limited by Section 2.2.4.

Contrary to GSU's contention, Section 2.2.1 does not provide a contractual basis pursuant to which the Commission may relieve GSU of its obligations under the UPSA. Any relief provided to GSU by the Commission necessarily depends upon a favorable finding under Section 206(a).

The language of Section 2.2.1 and of Schedule E does not make it applicable to Schedule E, and Schedule E does not contain a provision comparable to Section 2.2.1. To the extent that Schedule E represents part of the modification of the original UPSA and Interchange Contract transaction and to the extent that there is a relationship between the quantities of UPS capacity and Schedule E capacity under the Section 2.2.4 formula, any negotiation as to UPSA capacity under Section 2.2.1 may well entail an adjustment of capacity under Schedule E. Notwithstanding this tangential relationship between Section 2.2.1 and Schedule E, Section 2.2.1 is not sufficient to relieve GSU of its obligation to purchase capacity under Schedule E for the very same reasons as were discussed with respect to its obligations to purchase capacity under the UPSA.

Section 2.2.1 does not require GSU and Southern to proceed under a particular alternative. Section 2.2.1 merely requires the parties to evaluate alternatives in good faith and with diligence. The only basis for directing the adoption of a proposed alternative would be a finding under Section 206(a) that the UPSA or Schedule E are unjust, unreasonable, unduly discriminatory or preferential, or contrary to the public interest and that the proposed alternative is just and reasonable and not unduly discriminatory or preferential. Since the contracts were found above not to be unjust, unreasonable, unduly discriminatory or preferential or contrary to the public interest, no grounds exist to impose an alternative. Under the circumstances, Southern and Staff's suggestion that the parties

should be encouraged to pursue Mr. Franklin's proposed alternative has merit. Mr. Franklin's proposal would offer GSU some relief by temporarily deferring its capacity obligations. Accordingly, the parties are encouraged to pursue Mr. Franklin's alternative or an acceptable variation thereof.

Southern Sales of Capacity and Energy Under Interchange Contract

Issue 7: Whether Southern Companies are selling capacity and energy under the terms of the Interchange Contract which is not available under the terms of Service Schedule E?

In its complaint, GSU asserts that Southern lacked sufficient capacity to make the capacity contemplated by the UPSA, Schedule E and its agreements with other systems available. In framing Issue 7, the parties did not identify what particular sales, other than Schedule E, are at issue under the Interchange Contract.

Prior to the addition of Schedule E, the Interchange Contract consisted of eight service schedules dealing with short-term emergency power and economy sales.[1] Subsequent to the

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[1] *Service Schedules—Date*

Service Schedule A, SC Emergency Assistance—February 25, 1982

Service Schedule GES, GSU Emergency Service—February 25, 1982

Service Schedule B, SC Short-Term Power—February 25, 1982

Service Schedule GRE, GSU Replacement Energy—February 25, 1982

Service Schedule C, SC Economy Interchange—February 25, 1982

Service Schedule G-ECON, GSU Economy Energy Supply—February 25, 1982

Service Schedule GITS, GSU Interconnected Transmission Service—February 25, 1982

Service Schedule G-GEN GSU General Provisions—February 25, 1982

addition of Schedule E, the parties added Schedule R on August 2, 1985, which provides for non-firm UPS replacement energy.

GSU's allegations do not appear to concern the eight short-term emergency power and economy sales service schedules or Schedule R which are made under the Interchange Contract. To the extent that this issue relates to GSU's complaint that Southern did not have sufficient capacity and energy to meet its Schedule E obligations under the Interchange Contract or even its unit power obligations under the UPSA, the record establishes that Southern had sufficient capacity and energy to meet its contractual obligations. Indeed, GSU appears to have abandoned this allegation.[2]

Long Term Power

Issue 8: Whether the capacity and energy provided by Southern Companies to Gulf States under Schedule E constitutes "long-term power" as that term is defined under Section E1.1 of the Schedule?

The uncontroverted testimony of Southern's witnesses Guthrie and Usry supports a finding that the capacity and energy provided by Southern to GSU under Schedule E constitutes "long-term power" as that term is defined in Section E.1.1. Accordingly, Southern's Declaration 9 is granted with reference to this issue.

Fulfillment of Schedule E Obligation

Issue 9: Whether Southern Companies have continuously satisfied their contractual obligation to make available to Gulf States long term power in accordance with the provisions of Schedule E?

After an opportunity to examine hour-by-hour records furnished by Southern, both GSU's witnesses McLaughlin and

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[2] See testimony of Mr. McLaughlin, Tr. 239-241 and testimony of Dr. Murrill, Tr. 1320.

Murrill abandoned the contention that Southern was not able to meet its obligations under Schedule E. Thus, it is found that Southern has continuously satisfied its contractual obligation to make long-term power under Schedule E available to GSU. Declaration 9 requested by Southern as it applies to this issue will be granted.

Long-Term Power Definition

Issue 10: Whether the definition of "long-term power" contained in Schedule E applies or relates to the UPSA?

The parties presented no testimony or cross-examination on this issue. By its terms, the "long-term power" definition contained in Schedule E applies and relates to Schedule E and not to the UPSA. The UPSA was executed on February 25, 1982, some 21 months before the Interchange Contract was amended to include Schedule E. Sections 10.1 and 10.2 of the UPSA, which deal with the interrelationship of the two contracts, were not amended to incorporate the definition of long-term power of Schedule E into the UPSA. Accordingly, Southern's Declaration 10 is granted.

Southern Economy Energy Purchases from GSU

Issue 11: Whether economy energy purchases by Southern Companies from Gulf States or from other utilities proves or demonstrates a "need" on the part of Southern Companies for the capacity made available under Schedule E or for the capacity dedicated under the Unit Power Sales Agreement?

GSU's position on this issue was testified to by Dr. Murrill, Mr. McLaughlin and Mr. Hebert. They testified that Southern asked to purchase between 300 MWh and 500 MWh of energy from GSU and that GSU ultimately sold Southern approximately 709,000 MWh, at an average price of $20.41 per MWh, during the summer of 1986.

Southern's version of the transaction as testified to by Mr. Usry, is that Southern met with GSU and JEA on April 15,

1986, to explore the possibility of GSU selling energy to JEA. When that sale did not take place, Mr. Usry asked Mr. Naylor of GSU if Southern could assist GSU by purchasing economy energy from GSU and that Mr. Naylor said that such sales would benefit GSU financially. Southern represents that it acted out of a desire to help GSU and that it had no need for additional capacity during the summer of 1986.

GSU offered no rebuttal to Mr. Usry's version, and on cross-examination Mr. Hebert and Dr. Murrill agreed that there is no evidence that Southern purchased economy energy from GSU during the summer of 1986 because it needed capacity.

On the basis of the weight of the evidence in the record, it is found that the economy purchases by Southern from GSU do not demonstrate that Southern had a need for capacity on its system in the summer of 1986. Accordingly, Southern's Declaration 11 is granted.

State Regulatory Commission Actions

Issue 12: Whether the type of regulatory treatment of the cost associated with either the Unit Power Sales Agreement or Schedule E of the Interchange Agreement by the Louisiana Public Service Commission or the Public Utility Commission of Texas alters or affects Gulf States' contractual obligations under those agreements?

Issue 13: Whether Gulf States' contractual obligations under the Unit Power Sales Agreement and Schedule E are "excused, suspended and discharged" as a result of the decision by the Public Utility Commission of Texas to disallow pass-through of the capacity charges to retail rate-payers based on a finding of imprudence by Gulf States?

Issue 14: Whether the disallowance by the Public Utility Commission of Texas of pass-through of capacity charges to retail ratepayers based on a finding of imprudence by Gulf States prevents Gulf States from performing the contractual obligations owed Southern Companies under the Unit Power Sales Agreement and Schedule E of the Interchange Contract?

Issue 15: Whether the Unit Power Sales Agreement and Schedule E of the Interchange Agreement were premised on the assumption that the resulting expenses would receive favorable regulatory treatment by the Louisiana Public Service Commission and the Public Utility Commission of Texas?

Issue 16: Whether favorable regulatory treatment of expenses under the Unit Power Sales Agreement and Schedule E by the state commissions and perpetual economic benefit to Gulf States are conditions precedent or subsequent upon which Gulf States can avoid its contractual obligations owed Southern Companies under the Agreements?

Issue 18: Whether the disallowance of pass-through of capacity charges under the Unit Power Sales Agreement and Schedule E by the Public Utility Commission of Texas based upon a finding of imprudence by Gulf States "prevents" Gulf States from performing its obligations under the Agreements?

Issue 19: Whether a finding of imprudence on the part of Gulf States in entering into either the Unit Power Sales Agreement or Schedule E by the Public Utility Commission of Texas or the Louisiana Public Service Commission affects the enforceability of such agreements or provides a basis upon which Gulf States can avoid its contractual obligations?

A number of the issues posed relate to the actions of the LPSC and the PUCT. In its brief, GSU states that it will not, in regard to these issues, address any questions as to whether GSU has an impossibility defense under Texas law arising from the PUCT's denying GSU the right to pass-through the contract costs because the contracts were imprudent. It asserts, however, that the actions of the LPSC and the PUCT are relevant to the Section 206(a) inquiry in this proceeding. Although GSU is challenging the legality of the state commissions' actions in denying pass-through in the state appellate process, it argues that this Commission must assume, for purposes of this proceeding, that GSU has no present or future ability to collect from its customers any of the capacity costs imposed on it by the contracts at issue.

GSU urges consideration of the impact of state regulatory action in the following respects: (1) denial of pass-through makes it impossible for GSU to pay capacity charges; (2) denial of pass-through, coupled with the resulting accumulating contract liability, threatens GSU's ability to provide adequate service and threatens to push it into bankruptcy; and (3) denial of pass-through reflects a judgment by state regulators that the contracts are burdensome and are uneconomic for the customers, whose rates must support GSU's system and service. While it concedes that such judgement is not binding, GSU expresses the belief that it represents a salient fact which the Commission should assess.

In its brief, Southern traces the history of LPSC and PUCT actions regarding the UPSA and Schedule E. It notes that the LPSC intervened in Docket No. ER82-579-000 at the time of the original filing of the UPSA and fully participated in that proceeding, even sponsoring a witness, Mr. Louiselle, who recommended certain modifications to the UPSA. Subsequent to the 1983 amendments which added Schedule E and which formed the basis for a settlement approved by the Commission, the LPSC, in a brief to the Federal Court of Appeals for the D.C. Circuit in an ensuing appeal by Dow Chemical Company, stated the following with regard to the UPSA:

> The Secretary of the Louisiana Commission, in a meeting with representatives of Dow Chemical, stated the opinion that the Louisiana Commission would not review the prudence of reasonableness of the transaction because (a) the agreement is subject to the jurisdiction of the FERC and was approved by the FERC and (2) *the Louisiana Commission intervened in the proceeding and consented to the settlement agreement that the FERC approved.* Thus, he indicated that the Louisiana Commission would regard the Southern capacity as non-avoidable . . . (Emphasis added.)

(Ex. S-115, p. 9; Ex. S-9, pp. 33-34).

Southern further states that though the PUCT was not an intervenor in Docket No. ER82-579-000, it issued orders evi-

dencing its approval of GSU's UPSA with Southern. The PUCT, for example, granted GSU a Certificate of Convenience and Necessity pertaining to the 500-kV transmission line establishing the interconnection with Southern. In that order, PUCT found that the transmission line was "needed in order to enable GSU to obtain from Southern, power which is necessary to ensure adequate reserve margins and to help reduce dependence on oil or gas based energy." Southern states that in a later order, issued July 1984, the PUCT found that the contracts would provide significant savings for GSU's customers in 1984 and 1985. Consistent with these actions, both commissions permitted GSU to pass-through and recover costs associated with the contracts, either through rates or through fuel adjustment clauses.

Southern further points out that in 1985, notwithstanding the testimony of GSU witness Mr. McWhinney (Exs. S-108--S-109) to the PUCT that the contracts reflected prudent decisions and that the UPSA was beneficial, the PUCT indicated an intent to order a $120 million rate reduction. In May 1986, GSU agreed to a rate reduction of approximately $80 million, of which approximately $55 million was attributable to the costs associated with the UPSA and Schedule E. In October 1986, after further hearings, the PUCT disallowed the pass-through by GSU of capacity charges under both the UPSA and Schedule E.

On November 12, 1986, the LPSC followed suit and issued an order which disallowed collection of the capacity portion of the UPSA and Schedule E. Focusing on the earlier PUCT action, the LPSC determined that continued collection of capacity charges from Louisiana ratepayers would contravene the "doctrines of fundamental fairness and equal protection" and that the UPSA capacity was not "used and useful."

Southern asserts that GSU's regulatory treatment is irrelevant to the inquiry herein under Section 206(a) and has no bearing upon GSU's contractual commitments. It maintains that the actions of the LPSC and PUCT provide no basis for

abrogating or even modifying the contracts. Southern offers the following explanation of the policy considerations regarding this issue through the testimony of Dr. Lindsay:

> It is my understanding that the two state commissions refused to allow the pass-through of costs associated with these contracts on the ground that Gulf States was imprudent in executing the contracts. (At least one of the state commissions found imprudence, and the other acted in recognition thereof.) While the conclusion that Gulf States was imprudent in entering into these agreements is dubious at best, it is evident that Gulf States was either prudent or imprudent. If Gulf States was imprudent, then the Commission is being asked to relieve Gulf States from the consequences of its imprudence and to shift the burden of that imprudence to Southern, which has not been accused of imprudence by anyone. If, on the other hand, Gulf States was in fact prudent in entering into these contracts (contrary to the findings of the state commissions, whose orders I understand to have been appealed), then the Commission is being asked to 'rescue' Gulf States from improper (by assumption) findings of the state commissions. Again, this would shift to Southern the burden placed on Gulf States by its state commissions.

(Ex. S-72, pp. 11-12).

Southern concludes that, in either event, if the Commission acts in response to state commission action, its independent authority will be usurped.

Staff espouses a similar position. It asserts that GSU's inability to flow through costs is legally irrelevant and does not make the contracts unjust or unreasonable. Staff notes, as GSU witnesses Donnelly and Hebert admitted, that GSU is asking this Commission to abrogate GSU's contracts with Southern because of the regulatory treatment they received in Louisiana and Texas. Staff argues that if this Commission granted relief, it would merely shift costs, which were allocated by legally enforceable and binding contracts, from ratepayers in Texas and Louisiana to ratepayers in Alabama, Florida, Georgia and Mississippi. Staff further argues that as a matter of policy, this Commission should not place itself in a position of

mitigating the effects of state commission action with regard to the high costs of a new nuclear power plant, by permitting GSU to avoid its obligations under the pre-existing UPSA and Schedule E which it previously accepted. As a matter of law, Staff cites several cases[3] supporting the principle that state commissions may not preempt this Commission's regulatory authority.

GSU's argument in regard to the impact of state regulatory commission action upon a Section 206(a) determination is rejected. The actions of the state commission have no binding effect upon this Commission, whose authority, as already discussed, rests upon the standards of Section 206(a). Furthermore, GSU incorrectly assumes, for purposes of this proceeding, that it has no future ability to collect capacity costs from its customers. GSU admits that the state commissions' actions are not final and that it has appealed the state commission actions in the state courts. Until the state courts act, there is no basis to assume that GSU has no future ability to pass through capacity costs. GSU's assertion that the denial of pass-through of the capacity costs under the contracts threatens its ability to provide adequate and reliable service and threatens to push it into bankruptcy is not well founded. The record demonstrates that GSU is not making any payments to Southern for capacity and is making payments for only a small portion of the energy payments due Southern. Thus, apart from the state commissions' actions, the contracts do not have a significant impact upon GSU's present financial situation.

The regulatory treatment of the UPSA or Schedule E of the Interchange Contract by the LPSC and the PUCT does not alter or affect GSU's contractual obligations under those con-

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[3] *Pennsylvania Power & Light Company*, 23 FERC ¶ 61,325, at pp. 61,715-16 (1983). *Narragansett Electric Company* v. *Burke*, 119 R.I. 559, 381 A.2d 1359 (1987); *cert. denied* 435 U.S. 972 (1979). *Nantahala Power & Light Company* v. *Thornbury*, No. 85-568 (Sup. Ct. June 1986). *Appalachian Power Company* v. *West Virginia Public Service Commission*, No. 86-2540, *et al.* (4th Cir. March 4, 1987).

tracts. There are no provisions in either contract which specifically relieve GSU of its contractual obligations in the event of an adverse decision by a state regulatory commission. Nor is GSU "excused, suspended and discharged" from its contractual obligations under the UPSA or Schedule E as a result of the decision of the PUCT to disallow pass-through of the capacity charge to retail ratepayers based upon a finding of imprudence. Unfavorable retail rate treatment of a purchaser's expense by a state commission does not subject a unit power contract to termination. *Pennsylvania Power & Light Company*, 23 FERC ¶61,325, at pp. 61,715-16 (1983). It should be noted in this regard that denials of pass-through by the LPSC and the PUCT on the grounds of "imprudence" or of not being "used or useful" represents a reversal of their earlier support for the UPSA and Schedule E and the allowance of pass-through. Such an untimely reversal in their respective positions, under the circumstances, is unreasonable and disruptive of the orderly acquisition of power resources by electric utilities.

GSU is not prevented by a denial of pass-through from performing its contractual obligations under the UPSA or Schedule E. The orders of the PUCT or the LPSC do not mandate directly, or indirectly, GSU to breach any of its contractual obligations.

With specific reference to Issue 16, favorable regulatory treatment of costs under the UPSA or Schedule E and perpetual economic benefit to GSU are not found to be conditions precedent or subsequent under the UPSA or Schedule E.

Accordingly, Declarations 12, 14, 15, 19, 23, 25, 26 of Southern's Petition for a Declaratory Order are found to have merit and are granted.

Section 9.2 (Force Majeure)

Issue 17: Whether Section 9.2 of the Interchange Contract (the "force majeure" provision) applies or relates to the Unit Power Sales Agreement?

In its brief, GSU states that it does not rely on Section 9.2 in support of its complaint and has not presented evidence on it. GSU suggests that this issue should not be determined in isolation from the other issues which are before the Federal District Court.

Section 9.2 of the Interchange Contract makes no reference to the UPSA. Section 10.2 of the UPSA incorporates provisions of the Interchange Contract by reference into the UPSA. Section 10.2 of the UPSA does not incorporate Section 9.2 of the Interchange Contract into the UPSA. Southern witness Usry testified that neither GSU nor Southern ever suggested including a *force majeure* provision in the UPSA and that Section 9.2 was specifically excluded from the UPSA. Southern's Declaration 24 with reference to Section 9.2 is, therefore, granted.

Sections 7.2 and 7.3 (Dispute Provisions)

Issue 20: Whether Section 7.2 of the Interchange Agreement pertains to bona fide disputes involving cost data, computations and other such matters?

Issue 21: Whether Section 7.3 of the Unit Power Sales Agreement pertains to bona fide disputes involving cost data, computations and other such matters?

In its brief, GSU states that it does not rely on these sections to support its complaint and that it has presented no evidence with respect to them. It suggests that these issues should not be decided in isolation from the issues which are presently before the Federal District Court.

Sections 7.2 and 7.3 apply to bona fide disputes with respect to the calculation of bills or invoices under the respective contracts. No such disputes are raised in this proceeding. Southern's Declarations 27 and 28, with reference to Sections 7.2 and 7.3, are granted.

Pricing Mechanism

Issue 22: Whether the Southern Companies' pricing mechanism for capacity and associated energy in the Unit Power Sales Agreement is just and reasonable?

In its complaint, GSU challenges the pricing mechanism under the UPSA. GSU contends that the UPSA requires it to purchase power from the newest and thus most expensive plants existing at any given time on the Southern system and that the pricing formula has become unjust and unreasonable, since the plants are being constructed to serve Southern's corporate goals rather than GSU's needs. It maintains that the rates are excessive since they substantially exceed the price which Southern charges full-requirements customers for wholesale service. GSU further contends that, since Southern has the option of not delivering power under the UPSA 10 percent of the time due to the 90 percent capacity factor provision, the UPSA charges which exceed the costs for 90 percent of the capacity are discriminatory and unlawful under Section 206(a). GSU, however, does not contend that Southern's rates are not cost based or are computed other than in accordance with the contract formulas.[4] It also does not contend that any

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[4] Dr. Murrill testified as follows:

Q. Does anyone in this case on behalf of Gulf States, you being the policy witness in this case, say that the Southern Company are recovering in excess of their cost of providing the service under these contracts? Has anybody ever made that allegation? If they have, I would like you to point me out who has and where.

A. [Dr. Murrill] I think it is clear that the charges being made by The Southern Company are in accordance with the contracts as approved to provide the return on equity approved and consistent with what FERC approved. Nobody, I think, has made any suggestion to the contrary, that it is not being calculated in accordance with the general approval of FERC.

Q. And no one from Gulf States is making the contention that Southern Companies are receiving in excess of their cost of providing the service, that it is receiving excess profits from this, are they?

A. We are not claiming any . . . illegality.

Q. The rates, they recover Southern's investment costs in the

other UPS customer has a more favorable pricing mechanism.[5]

Under the Section 206(a) review, the standard to be applied is whether the pricing mechanism is unjust and unreasonable, rather than whether it is just and reasonable. GSU has not demonstrated that the pricing mechanism under the UPSA is unjust, unreasonable, unduly discriminatory or preferential. The UPSA rates are higher than the rates for full-requirements wholesale service because the wholesale service rates are based on Southern's average system costs whereas the UPSA rates are based on the actual costs of the units con-

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units; they do that, don't they?

A. Yes.

Q. And by that I mean the carrying cost of its bonds, preferred stock and common equity, and supports the investment in the units?

A. Yes.

Q. And it recovers its operations and maintenance expense associated with those units?

A. Yes.

Q. [I]s Southern Company getting anything more than its cost, are you—is there any allegation that we are getting anything more than that?

A. No.

(Tr. 1237, 1239)

[5] Dr. Murrill testified as follows:

Q. You have said several times in your testimony, Dr. Murrill, that these contracts, namely the unit power sales agreement, is discriminatory; is that correct?

A. [Dr. Murrill] Yes.

Q. And you say that the contracts are discriminatory. Do you mean that Southern Companies are selling to similarly situated customers to Gulf States at lower prices than Southern Companies are selling to Gulf States?

A. No.

Q. You are not alleging, are you, Dr. Murrill, that Southern Companies treat Gulf States differently from other UPS customers that is has?

A. I am not alleging that, no.

(Tr. 1320-1321).

structed and committed to GSU under the terms of the UPSA. GSU contracted for unit power from designated units, which it could treat as if they were a part of its own system, and in doing so, GSU agreed to pay for the actual cost of the units. Thus, the differences between the unit power sale and full-requirements wholesale service justify the somewhat higher rate. GSU's Dr. Murrill conceded that Southern did not mislead GSU about the price it would pay under the UPSA or about the fact that these units would be the newest and, therefore, the most expensive on Southern's system. Rates for such unit power are just and reasonable when they are cost based. *See, Ohio Edison Co.*, 23 FERC ¶ 61,344, at p. 61,749 (1983). No party contends that the unit power costs or Schedule E costs herein are not cost based. The fact that GSU pays a higher rate for UPS power than a full-requirements customer pays for wholesale service does not render the UPS rate unjust, unreasonable, unduly discriminatory or preferential because the difference in price is justified.

GSU and SRG&T argue that the contracts are tied to GSU's avoided costs of energy, principally based on natural gas, and that to the extent that the costs of capacity and energy under the contracts now exceed GSU's avoided costs, the costs of capacity and energy under the contracts are unjust and unreasonable. In support of their avoided costs argument, GSU and SRG&T point to Section 2.2.4, which was added to the UPSA in 1983 and to which GSU refers as an "automatic adjustment mechanism." GSU and SRG&T assert that under Section 2.2.4, the parties determine each year whether the total cost of power under the contracts is less than the cost of GSU's avoided cost of generating energy.

Section 2.2.4 is not a pricing mechanism based on avoided costs. Rather, as previously discussed, it is a formula for determining the amount of unit power capacity which GSU is obliged to take. Section 2.2.4 was not part of the UPSA at the time of the original unit power purchase. When the parties negotiated a change in the UPSA, reducing the amount of capacity thereunder, they provided for lower cost Schedule E capacity in an

amount equal to the UPSA capacity reduction. Southern apparently afforded GSU this relief primarily because of lower gas prices. Since the need for this relief would be obviated if gas prices rose, it is evident that Section 2.2.4 was included by the parties to return Southern to its *status quo ante* should gas prices rise. It is found, therefore, that Section 2.2.4 is not a pricing mechanism that ties the cost of the UPSA or Schedule E power to GSU's avoided costs of energy. The costs for capacity and energy under the UPSA and Schedule E are found to have been properly determined in accordance with the terms of those contracts.

As for GSU's contentions regarding the effect of the 90 percent capacity factor, GSU agreed to this power factor provision which is common in purchasing unit capacity. GSU may not now complain about a provision to which it agreed as part of the total UPSA transaction without a showing as to why it is inherently unjust or unreasonable. GSU has not made such a showing.

Notwithstanding GSU's contention, through its witness Louiselle, that the UPSA is an atypical unit power agreement, the record shows that the UPSA is quite similar to other unit power agreements approved by this Commission. To the extent that the UPSA varies from other unit power agreements, the record shows that these differences operate to GSU's advantage. Not only are Southern's UPSA rates cost-justified but, as conceded by GSU witness Murrill, they are not excessive in relation to GSU's own coal and nuclear power costs (Ex. S-50), and they are actually lower than originally projected by Southern.

It is concluded that the pricing mechanism in the USPA is not unjust, unreasonable, unduly discriminatory or preferential.

GSU Capacity Sales

Issue 23: Whether Gulf States has affirmatively and diligently attempted to sell capacity which it generates or purchases that is surplus to its own requirements?

Section 2.2.5 of the UPSA provides that the amount of capacity to be purchased by GSU under Section 2.2 can be reduced, at GSU's option, if GSU or Southern can find a third party who will assume all or a portion of GSU's obligation, subject to Southern's approval.

On cross-examination, GSU witness Dr. Murrill stated that GSU discussed the possibility of making sales to utilities in the ERCOT Reliability Council area with members of the PUCT, but there are presently no transmission lines available to GSU which would allow such sales. Nevertheless, there were extensive negotiations between GSU and HL&P. In addition, GSU hired Mr. McWhinney as a consultant to help with the effort. Mr. Naylor testified on behalf of GSU that his efforts to sell GSU's surplus capacity centered mainly on utilities in the Southwest Power Pool Reliability Council area.

The record establishes that GSU did attempt to sell the capacity from the Southern contracts which was excess to its own needs, but it did so without any success.

Reliance by Southern Companies

Issue 24: Whether Southern Companies' construction plans were based upon the Unit Power Sales Agreement and Schedule E and, if so, the extent of the reliance of Southern Companies on such Agreements?

Extensive testimony was presented by GSU and Southern on this issue. As Southern noted in its brief, however, the reason why GSU and SRG&T have placed so much emphasis on the question of reliance is not entirely clear. Southern suggests that one possible explanation, which it discerns from GSU's complaint, is that the Commission could somehow abrogate the contracts without financially harming Southern if Southern had not relied upon the UPSA when it built the units.

While GSU and SRG&T incorporate the issue of reliance into their Section 206(a) arguments, the question as to what extent Southern relied upon the UPSA in continuing construction of

the designated units is not relevant to a determination of whether the UPSA and Schedule E are unjust, unreasonable, unduly discriminatory or preferential or contrary to the public interest. What is relevant, is whether Southern fulfilled its obligation to have certain units available under the contracts and whether it incurred costs in doing so and whether its charges are based on those costs. In light of the foregoing determination on the Section 206(a) issues, the reliance issue need not be reached, since it appears to relate to the question of possible remedies and their impact upon Southern. As all of the issues posed by the parties are being addressed, the merits of this issue will be briefly discussed.

The overwhelming evidence, presented through Southern witnesses Franklin, Guthrie, and Williams, GSU witness Louiselle's previous testimony in Docket No. ER82-579-000, and GSU's chief negotiator Mr. Bondurant's testimony on deposition, establishes that Southern relied on these contracts and on the revenues to be derived therefrom in planning to continue construction of the units dedicated to the UPSA. Neither the testimony offered by GSU through Mr. Mozer, who had only two days to review the pertinent materials and prepare his testimony and who was unable to reach an opinion on this issue, nor the testimony of GSU witness Naylor, who was the only witness to testify that Southern would have constructed the generating units whether or not GSU had contracted for the capacity and agreed to pay for it, overcomes the weight of Southern's evidence on this issue. Much of the direct testimony and cross-examination, which sought to explore what Southern might have done had GSU not contracted for 1,000 MW of capacity is speculative. The inescapable fact emerges that upon entering into the UPSA with GSU for 1,000 MW of capacity, Southern proceeded with construction of the units with the expectation that it would have revenues to pay for it. Southern's reliance on Schedule E after the 1983 amendments was of a different nature, since Schedule E power is not tied to particular units. While the 1983 amendments reduced the capacity obligations of Southern at a significant cost to it, Schedule E

imposed a new requirement on the Southern system, as well as a source of expected revenues.

Southern Companies Forecasted Loads

Issue 25: Whether previously forecasted loads have failed to materialize on the systems of the Southern Companies and, if so, does that fact impact the relief which Gulf States may obtain in this proceeding?

Consistent with its position that it should be relieved of its obligations under the UPSA and Schedule E, GSU attempted to demonstrate, through the testimony of its witnesses McLaughlin, Hebert and Lanou, that Southern will need additional capacity during the contract period. As framed, this issue assumes that GSU is entitled to relief, but this does not constitute a waiver by Southern of the issue as to whether or not GSU is entitled to relief under Section 206(a). In light of the determination on the Section 206(a) issues above, this issue dealing with the relief GSU might be entitled to is rendered moot.

Nevertheless, in addressing this issue, the thrust of GSU's argument is that if UPSA capacity was returned to Southern as of May 31, 1987, Southern's projected reserve level would remain well within its target range in both 1987 and 1988 and would only slightly exceed the target range in 1990 and in 1991. GSU offered the testimony of Mr. Lanou, who took the position that Southern's load forecasts were consistently underestimated and that there is a significant chance that Southern subsidiaries may continue to underestimate their peak loads. From this Mr. Lanou concluded that Southern is far more likely than GSU to be able to make efficient use of the UPSA capacity over the contract term.

Southern disputes the accuracy of GSU's analysis of Southern's projected load and reserves. Southern states that under

its official 1987 Generation Expansion Plan, projected reserve levels are as follows:

Year	*Percent Reserves (1987 Plan)*
1987	20.90
1988	18.60
1989	26.00
1990	23.50
1991	22.90

(Ex. S-9, pp. 64-65).

Southern maintains, on the basis of testimony by Mr. Shepard, its Director of System Planning, that the average reserve levels for the 1987 through 1991 period are a clearly adequate 22.83 percent. Witness Franklin testified that since 1982 the only significant changes in Southern's plan are a lower long-term load forecast and a resulting decision to delay construction of the 850-MW Rocky Mountain Plant from 1987 to 1991 and then to 1999. Witness Shepard recognized that Southern's short-term peak demand growth is somewhat higher than what was once projected.

Staff asserts that Southern does not need the capacity and energy it is selling to GSU until after the contracts at issue have expired. Moreover, it concedes that its initial suggestion to defer certain units on the Southern system would result in a penalty to Southern in excess of $1 billion (Ex. S-54), and Staff has abandoned it.

The evidence, particularly from the cross-examination of GSU's witness, reveals that GSU has failed to establish that Southern needs the capacity in question during the contract term. Southern's load forecasts, which have been shown over a period of many years to be very reliable, are lower than originally anticipated. Accordingly, it is found that forecasted loads on the Southern system, as well as projected reserve levels, do not indicate that Southern will require the unit power in question during the term of the UPSA.

Further Findings and Conclusions

(1) The Southern Companies are public utilities under the Federal Power Act.

(2) GSU is a pubic utility under the Federal Power Act.

(3) The contracts involved in this proceeding apply to sales of electric power and energy for resale and are subject to the jurisdiction of the Federal Energy Regulatory Commission.

(4) The contracts at issue have not been shown to be unjust, unreasonable, unduly discriminatory or preferential or contrary to the public interest under Section 206(a) of the Federal Power Act.

(5) GSU's complaint is not meritorious and should be dismissed.

(6) Declarations 9, 10, 11, 12, 14, 15, 19, 23, 24, 25, 26, 27 and 28 of Southern's Petition for a Declaratory Order, as amended, having been set for hearing by the Commission and having been shown to have merit, should be granted.

(7) The three questions specifically posed by the Commission over which it has asserted jurisdiction in its order are the subject of findings as set forth in this decision.

Order

Wherefore, it is ordered, subject to review by the Commission on appeal or on its own motion, as provided in the Commission's Rules of Practice and Procedure, that:

(A) GSU's complaint be, and is, hereby dismissed, and the proceeding thereon is terminated.

(B) Southern's Petition for a Declaratory Order, with regard to the particular declarations ordered by the Commission to be heard in this proceeding, is hereby granted.

Supreme Court, U.S.
FILED
APR 27 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-1368

In the Supreme Court of the United States

OCTOBER TERM, 1989

GULF STATES UTILITIES COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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BEST AVAILABLE COPY

QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission properly concluded that, in the circumstances of this case, contract rates between petitioner and the Southern Companies for the purchase and sale of electric capacity and energy had not become unjust, unreasonable, unduly discriminatory or preferential and that the public interest did not require that petitioner be relieved of its contractual commitments.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The order of the court of appeals affirming the Federal Energy Regulatory Commission's orders (Pet. App. 1a) is unreported. The opinions and orders of the Federal Energy Regulatory Commission and its administrative law judge (Pet. App. 4a-32a, 33a-36a, 37a-118a) are reported at 39 F.E.R.C. ¶ 63,026, 43 F.E.R.C. ¶ 61,003, and 43 F.E.R.C. ¶ 61,394.

JURISDICTION

The judgment of the court of appeals was entered on September 22, 1989, and a petition for rehearing was denied on November 27, 1989 (Pet. App. 2a-3a). The petition for a writ of certiorari was filed on

February 26, 1990 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner seeks review of the court of appeals' affirmance of the Federal Energy Regulatory Commission's orders determining that two contracts for electric power between petitioner and Southern Companies had not become unjust or unreasonable under Section 206(a) of the Federal Power Act [1] and that the public interest did not require that they be set aside.

1. Petitioner is a public utility serving Texas and Louisiana. In February, 1982, petitioner entered into contracts with Southern Companies, a public utility holding company selling electricity in Alabama, Georgia, Florida, and Mississippi. Petitioner agreed to purchase 500 megawatts per year, for the period from June 1984 through May 1992, of Southern's then highly-economical, coal-fired electrical generating capacity (and associated energy) and agreed to terms and conditions of service on an interconnec-

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[1] Section 206(a) of the Federal Power Act (16 U.S.C. 824e(a)) provides in pertinent part:

> Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affect[ing] such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

tion to be established between petitioner and Southern. Pet. App. 41a-43a; Pet. 4.

When petitioner entered into these contracts, its River Bend Nuclear Plant was under construction and scheduled to begin operating in January of 1986. Petitioner planned to use Southern Companies' then comparatively inexpensive coal-fired power, its own coal-fired power, and, when it became available, its own nuclear power to meet base-load requirements. Petitioner planned to use comparatively expensive gas-fired and oil-fired power to meet demand during peak periods. On March 23, 1984, the Commission approved the contracts (with amendments agreed to by the parties) and found them just and reasonable and in the public interest. *Southern Co. Services, Inc.*, 26 F.E.R.C. ¶ 61,300 (1984); Pet. App. 44a-47a.

2. By 1985, demand for electricity had fallen, and oil and gas prices had dropped. Petitioner's problems increased when the Louisiana Public Service Commission and the Public Utilities Commission of Texas found petitioner to have been imprudent in entering into the contracts with Southern and refused to permit full recovery of those charges in retail rates. Petitioner and Southern proceeded with negotiations concerning relief for petitioner, but they ultimately reached an impasse. Pet. App. 47a-49a.[2]

On July 2, 1986, petitioner filed suit in the Eastern District of Texas against Southern, charging Southern with breach of contract, the torts of bad faith

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[2] Both the administrative law judge and the Commission determined that there was no contractual basis for relieving petitioner of its commitments. Pet. App. 8a-9a, 29a-30a, 90a, 98a. Petitioner has not sought review of this aspect of the decisions.

dealing and fraud, and a violation of the Texas Deceptive Practices-Consumer Protection Act. Pet. App. 49a; *Gulf States Utilities Co.* v. *Alabama Power Co.*, No. B-86-634-CA (E.D.Tex).[3] The suit is pending in district court.

3. In the wake of the filing of the lawsuit, in August, 1986, both petitioner and Southern sought concurrent relief from the Commission, and the matters were consolidated and set for hearing. On May 12, 1987, after an extensive evidentiary hearing, the administrative law judge (ALJ) issued his opinion. Pet. App. 37a-118a. The ALJ concluded that the contracts had not been shown to be unjust, unreasonable, unduly discriminatory or preferential or contrary to the public interest under Section 206(a) of the Federal Power Act. Rather, he found that the contract rates were based on Southern's cost of service. Pet. App. 58a-65a. He also concluded that the "changed circumstances" complained of by petitioner were—with the exception of the state regulatory commissions' actions—foreseeable and had actually been considered by the parties (*id.* at 74a); that there was no unfair distribution of contractual benefits and burdens (*id.* at 74a-82a); that petitioner's financial difficulties stemmed primarily from its failure to secure rate relief in connection with its River Bend Nuclear Plant (*id.* at 87a); that relief under the contracts at issue here would not have relieved petitioner's cash-flow problems (*ibid.*); that price differences between Southern's rates to petitioner and to its full requirements customers were

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[3] Southern appealed the district court's exercise of jurisdiction, and the Fifth Circuit affirmed the district court's authority to resolve some aspects of the dispute and remanded the case. See *Gulf States Utilities Co.* v. *Alabama Power Co.*, 824 F.2d 1465, modified, 831 F.2d 557 (1987).

justified and, therefore, not unduly discriminatory or preferential (*id.* at 112a); that the contracts did not adversely affect the public interest (*id.* at 91a); and that maintaining the stability and integrity of public utility contracts was in the public interest (*ibid.*).

4. On April 1, 1988, the Commission affirmed. The Commission, although not convinced of the legal relevance of some of petitioner's contentions, considered all the evidence in the record, and concluded that grounds for modification of the contracts had not been established. The Commission determined that the "pricing mechanism in the * * * contract is not unjust, unreasonable, unduly discriminatory or preferential." Pet. App. 11a. The Commission explicitly adopted the ALJ's decision on a number of points, including unforeseen changed circumstances, equitable considerations, and the effect of the state commission decisions upon the justness and reasonableness of the parties' agreements. *Ibid.* The Commission also specifically addressed petitioner's contentions, in light of the evidence in the record, concerning the relative burdens and benefits under the contract (*id.* at 17a-18a), petitioner's financial situation (*id.* at 19a-20a), Southern's alleged lack of reliance and need for capacity (*id.* at 21a-23a), and the claimed lack of efficiency resulting from the contracts (*id.* 23a-25a). The Commission concluded that none of these factors justified modification of the contracts, particularly in view of the statutorily required "value of preserving contract stability in the electric utility industry." *Id.* at 24a.

On June 1, 1988, the Commission denied petitioner's motion for rehearing. Pet. App. 33a-36a.[4]

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[4] Petitioner had been depositing the amounts owed under the contracts with the district court in Texas. Eventually,

5. In a brief, per curiam order issued on September 22, 1989, the court of appeals affirmed. The court noted that its affirmance was "[s]ubstantially for the reasons stated by the Commission." Pet. App. 1a.

ARGUMENT

The court of appeals correctly upheld the Commission's decision that, under Section 206(a) of the Federal Power Act, the contracts between petitioner and Southern had not become unjust, unreasonable, or unduly discriminatory or preferential. The Commission properly emphasized that Southern received no more than the seller's cost of service, including a reasonable return on its investment—a long-established basis for determining the justness and reasonableness of a rate[5]—and that none of petitioner's asserted "non-cost considerations" justified modification of the contract. Pet. App. 8a, 10a-12a.

Petitioner nevertheless contends (Pet. 14) that the Commission erred by failing to give proper consideration to three factors: (1) the disparity between its

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however, it stopped making those deposits. In June, 1988, Southern received permission from the Commission to suspend its service to petitioner. *Southern Co. Services, Inc.*, 44 F.E.R.C. ¶ 61,290, at 62,039-62,041 (1988). See also Pet. 10-11 n.13.

[5] See, *e.g.*, *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 596, 603 (1944); *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 596-598 (1942). Cf. *Duquesne Light Co.* v. *Barasch*, 109 S. Ct. 609, 619 (1989). Because of the similarity between Sections 205(e) and 206(a) of the Federal Power Act (16 U.S.C. 824d(e), 824e(a)) and Sections 4(e) and 5(a) of the Natural Gas Act (15 U.S.C. 717c(e), 717d(a)), decisions construing the "just and reasonable" requirement of the Natural Gas Act provisions are applicable to the Federal Power Act provisions. See, *e.g.*, *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 349-353 (1956).

burdens and Southern's benefits; (2) its financial circumstances; and (3) the applicability of the "*Mobile-Sierra*" doctrine to a purchaser. With respect to each of these issues, however, the Commission specifically considered the evidence in the record and rejected petitioner's claim. These fact-based determinations do not warrant review.

1. Petitioner primarily objects (Pet. 15-20) to the Commission's treatment of its argument concerning a disparity between its burdens and Southern's benefits. The Commission observed that the considerations raised by petitioner in support of this claim were "not germane to an assessment of the contracts' justness and reasonableness." Pet. App. 15a. Despite this statement, however, the Commission also carefully considered petitioner's argument in light of the evidence, and rejected it on the basis of the facts in the record: "Assuming *arguendo* that [petitioner's] burdens/benefits arguments are appropriately considered, [petitioner] has failed to establish that it is suffering 'losses' under the contract, while the Southern Companies are reaping 'benefits' in excess of their costs." *Id.* at 17a. The Commission concluded that the evidence simply did not support petitioner's claim (*id.* at 17a-18a); the Commission emphasized, for instance, that the analysis of benefits and burdens prepared by petitioner's witness was erroneous in several respects, and that the witness himself had conceded error in the analysis. *Id.* at 14a, 17a-18a. Thus, contrary to petitioner's contention, its argument concerning benefits and burdens received full consideration by the Commission and was rejected on the basis of the evidence in the record.[6]

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[6] Indeed, petitioner acknowledges that the Commission evaluated its claim in light of the evidence in the record, but seeks

2. Petitioner also objects (Pet. 14) to the Commission's treatment of its financial hardship argument. The Commission suggested that it was "not convinced" that financial hardship, even if substantiated by the evidence, "would justify relief under section 206(a) of the FPA from [petitioner's] contracts with the Southern Companies under the circumstances presented by this case." Pet. App. 19a. Again, however, the Commission went on to consider fully petitioner's claim in light of the evidence in the record: "In any event, we are not persuaded by the evidence that relief would be warranted in this case for the reasons advanced by [petitioner] in this proceeding, even if financial hardship were a proper basis for relief." *Ibid.* The Commission observed that the evidence in the record did not support petitioner's claim that the contracts with Southern were the reason for its financial difficulties (*id.* at 19a-21a); the Commission also noted that the cross-examination of petitioner's chief financial officer undermined the credibility of petitioner's financial hardship argument. *Id.* at 20a. Here, too, the Commission explicitly rejected petitioner's contention on the basis of the evidence in the administrative proceeding.

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to minimize the significance of that review. Pet. 20 n.27. Petitioner's reliance on *Schwabacher* v. *United States*, 334 U.S. 182 (1948), moreover, is misplaced. In *Schwabacher*, "the record indicate[d]" that the Interstate Commerce Commission might have declined to consider certain claims because it believed it did not have jurisdiction. *Id.* at 201. Here, in contrast, the record reveals that the Commission fully considered petitioner's claims, and rejected them on the basis of the evidence before it.

3. Finally, petitioner objects (Pet. 26-28) that the Commission has refused to apply the "*Mobile-Sierra*" doctrine to purchasers.[7] The Commission, however, found it unnecessary to address this issue:

> With respect to [petitioner's] *Mobile-Sierra* financial hardship argument, we need not decide, in this case, whether it is appropriately raised by a purchaser which seeks to be relieved of its contractual obligations, rather than by a seller. Whatever the parameters of the *Mobile-Sierra* standard, we find * * * that [petitioner] has not demonstrated that the contracts with the Southern Companies should be modified on account of financial considerations.

Pet. App. 13a. The Commission then proceeded to address petitioner's claim of financial hardship and misallocation of benefits and burdens, as previously described, and concluded that the record did not support petitioner's contention regarding these points. As a result, the *Mobile-Sierra* issue that petitioner raises was explicitly reserved by the Commission; the state of the record in this proceeding did not require its resolution. Such a disposition does not afford a basis for this Court's review.

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[7] See *United Gas Pipeline Co.* v. *Mobile Gas Corp.*, 350 U.S. 332 (1956); *FPC* v. *Sierra Pacific Power Corp.*, 350 U.S. 348 (1956). Under this doctrine, the Commission may modify a rate if the fixed rate is "so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excess burden, or be unduly discriminatory." *Sierra Pacific*, 350 U.S. at 355. See also Pet. App. 12a n.9.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL 1990

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* The Solicitor General is disqualified in this case.

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No. 89-1368

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IN THE

Supreme Court Of The United States

OCTOBER TERM, 1989

GULF STATES UTILITIES COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, et al.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOINT BRIEF OF RESPONDENTS SOUTHERN COMPANY SERVICES, INC., ALABAMA POWER COMPANY, GEORGIA POWER COMPANY, GULF POWER COMPANY AND MISSISSIPPI POWER COMPANY IN OPPOSITION TO THE PETITION

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April 30, 1990

BEST AVAILABLE COPY

QUESTIONS PRESENTED

Through long-term power sale contracts, freely negotiated at arms length between unaffiliated utilities, Southern Companies (Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company and Southern Company Services, Inc.) committed to construct certain dedicated generating units and to provide specified capacity and energy from those units in accordance with the contract terms. The buyer, Gulf States Utilities Company ("Gulf States"), committed to take such capacity and energy over a specified term, and to pay rates based upon Southern Companies' cost of providing the service. Southern Companies have fulfilled their contractual commitments in every respect. The questions presented are:

1. Under section 206 of the Federal Power Act, 16 U.S.C. § 824e, did the Federal Energy Regulatory Commission ("Commission" or "FERC") err in refusing to abrogate these contracts (which would have shifted the cost responsibility back to the customers and stockholders of Southern Companies) in response to state commission decisions in Texas and Louisiana: (i) denying adequate retail rates associated with Gulf States' newly constructed River Bend Nuclear Plant, thereby causing its overall financial condition to be weakened; and (ii) ordering Gulf States to cease passing through to its retail customers the purchase costs associated with the contracts with Southern Companies due to alleged "imprudence" on the part of Gulf States?

2. Under section 206 of the Federal Power Act, 16 U.S.C. § 824e, did the Commission err in refusing to abrogate these contracts in response to claims by Gulf States that the purchases had become uneconomic or otherwise undesirable from its perspective, particularly when FERC found, as a matter of fact, that there was no "mismatch" of benefits and burdens between the parties or any other non-cost factor that would justify that requested relief?

3. Did the Commission err in its determination that, based on the circumstances and evidence presented, abrogating these contracts would undermine important policy goals under the Federal Power Act, including preserving the stability and integrity of contracts in the electric utility industry?

LIST OF PARTIES AND RULE 28.1 LIST

The parties to the appeal before the United States Court of Appeals for the District of Columbia Circuit were:

1. Gulf States Utilities Company — Petitioner
2. Federal Energy Regulatory Commission — Respondent
3. Southern Company Services, Inc. — Intervenor
4. Alabama Power Company — Intervenor
5. Georgia Power Company — Intervenor
6. Gulf Power Company — Intervenor
7. Mississippi Power Company — Intervenor
8. Louisiana Public Service Commission — Intervenor
9. Sam Rayburn G & T Electric Corporation, Inc. — Intervenor

Southern Company Services, Inc., Alabama Power Company, Georgia Power Company, Gulf Power Company and Mississippi Power Company are all wholly owned subsidiaries of The Southern Company, a public utility holding company registered under the Public Utility Holding Company Act of 1935. Savannah Electric and Power Company, which became a wholly owned subsidiary of The Southern Company in 1988, is not a signatory to the contracts and therefore was not a party before the Commission or in the subsequent appeal.

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No. 89-1368

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GULF STATES UTILITIES COMPANY,
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v.

FEDERAL ENERGY REGULATORY COMMISSION, et al.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOINT BRIEF OF RESPONDENTS SOUTHERN COMPANY SERVICES, INC., ALABAMA POWER COMPANY, GEORGIA POWER COMPANY, GULF POWER COMPANY AND MISSISSIPPI POWER COMPANY IN OPPOSITION TO THE PETITION

Respondents Southern Company Services, Inc., Alabama Power Company, Georgia Power Company, Gulf Power Company and Mississippi Power Company ("Southern Companies") request that this Court deny the petition for a writ of certiorari seeking review of the unreported judgment, filed September 22, 1989, of the United States Court of Appeals for the District of Columbia Circuit.

OPINIONS BELOW

The opinions below are identified in the petition ("Pet.") filed by Gulf States Utilities Company ("Gulf States"), and are reprinted in the appendix thereto ("Pet. App.").

JURISDICTION

The judgment of the court of appeals was filed on September 22, 1989, (Pet. App. at 1a), with a petition for rehearing and a suggestion for rehearing en banc being denied by orders filed November 27, 1989. (Pet. App. at 2a, 3a). The petition for a writ of certiorari, invoking the jurisdiction of this Court under 28 U.S.C. § 1254(1), was filed on February 26, 1990.

GOVERNING STATUTORY PROVISION

The statutory provision governing this matter is section 206(a) of the Federal Power Act, 16 U.S.C. § 824e(a), as set forth in Gulf States' petition. (Pet. at 2-3).

STATEMENT OF THE CASE

In its petition, Gulf States begins with a lengthy and purportedly factual statement of the nature, history and purpose of the contracts underlying this dispute. That self-serving recitation is nothing more than an argumentative replication of its evidentiary presentation below, a presentation that in all material respects was found to be unpersuasive and unavailing.[1] For an objective and balanced state-

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[1]Gulf States' petition is littered with factual assertions that have been found to be untrue, first by the Administrative Law Judge and then by the Commission. The most prominent of these (indeed, the very foundation for the petition) is the repeated claim that the contracts are producing an "unintended, inefficient and unfair distribution of benefits and burdens" between the buyer and the seller. (*See, e.g.*, Pet. at i, 3, 5, 14, 15, 19, 25, 28). The record below firmly establishes, however, that no such "mismatch" exists, that the "benefits/burdens" analysis sponsored by Gulf States was conceptually flawed and incomplete, and that Gulf States has received and would continue to receive benefits from the contracts. (Pet. App. at 74a-82a, 13a-18a). In a transparent attempt to finesse this fatal evidentiary

ment of the facts, Southern Companies commend to the Court that portion of the initial decision entitled "Factual Background." (Pet. App. at 41a-49a). There, the FERC Administrative Law Judge ("ALJ") has accurately summarized the rather extensive background facts and, when necessary, has resolved conflicting factual assertions by the parties.

Although satisfied with the ALJ's statement of the facts, Southern Companies will, in the interest of completeness, briefly discuss: (i) the nature of the case; (ii) the historical background leading to the execution of the contracts and their initial approval by the Commission; (iii) the proceedings before the Commission; and (iv) the performance (or, in the case of Gulf States, the lack of performance) of the parties during the pendency of those proceedings.

A. Nature of the Case

This petition centers on two wholesale electric power supply contracts between Southern Companies (the sellers) and Gulf States (the buyer): the Unit Power Sales Agreement ("UPS Agreement") and Service Schedule E to the Interchange Contract[2] ("Schedule E"). "Unit power" is a type of sale involving the dedication of a discrete portion of a

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failure, Gulf States repeatedly chides the Commission for its "purported" examination of the facts. (*See, e.g.*, Pet. at 12, 20 n.27).

Another noteworthy factual inaccuracy is the claim that "Gulf States established that relief from the contract at issue is essential to its financial viability," and that FERC "refused to consider" this effect on Gulf States' financial position. (Pet. at 5). In making this assertion, Gulf States simplistically equates an adverse result below with a failure on the part of FERC to "consider" its arguments. In truth, the evidence "overwhelmingly establishes" that its financial difficulties are traceable to the need for retail rates to cover the River Bend Nuclear Plant, and not to the contracts with Southern Companies. Moreover, it was proven that the financial problems would not be solved even if these contracts were abrogated. (Pet. App. at 82a-87a, 18a-21a).

[2]An interchange contract establishes the terms and conditions governing the physical connection of the parties' respective electrical systems. Customarily appended to an interchange contract are several service schedules pertaining to various types of transactions that may occur from time to time between the parties.

specified generating unit (or units) to the exclusive use of the purchaser, and entails both capacity[3] and energy[4] components. Schedule E provides for the sale of "long-term power" out of a mix of generating units, and is subject to interruption under specified circumstances. This transaction likewise involves both capacity and energy. Both the UPS Agreement and Schedule E were the product of arms-length negotiations between completely unrelated and unaffiliated commercial entities.[5] Indeed, the electrical systems of Southern Companies and Gulf States had never been physically connected prior to the execution of the UPS Agreement.

Although initially couched in terms of contract "modification," Gulf States has first asked the ALJ, then the Commission, next the court of appeals and now this Court to abrogate its freely-assumed obligations under contracts that it no longer finds sufficiently beneficial or advantageous. To make this plea, Gulf States focuses exclusively on *its* customers, *its* stockholders, *its* financial difficulties and *its* retail regulatory problems, and castigates the Commission for failing to respond to these concerns. In so doing, however, Gulf States neatly omits any mention of the counterbalancing impact of contract abrogation on the customers, stockholders, financial conditions and retail regulatory situations of Southern Companies. Granting the relief sought by Gulf States would not cause the fixed (or "sunk") costs associated

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[3]"Capacity" means the power generation capability available from an electric generating facility or group of facilities.

[4]"Energy" means the electricity produced through the utilization of capacity.

[5]In its petition, Gulf States vainly attempts to draw support from the decision in *Mississippi Industries v. FERC*, 808 F.2d 1525 (D.C. Cir.) ("*Mississippi Industries*"), *rev'd and remanded in part*, 822 F.2d 1104 (D.C. Cir.), *cert. denied*, 484 U.S. 985 (1987). (Pet. at 14 n.17, 28). Unlike the Southern Companies-Gulf States transaction, however, the contract at issue in *Mississippi Industries* involved affiliated operating companies of the same holding company that for many years had planned, built and operated on a totally integrated basis. Under such circumstances, the court affirmed the Commission's determination that it would be discriminatory under section 206 to permit one of the four operating companies to escape all cost responsibility for a nuclear plant that it, along with the other affiliated companies, had jointly agreed to build.

with the generating units contractually dedicated to Gulf States to disappear, but instead would only shift these costs to Southern Companies (which have fully complied with their end of the bargain). The fixed costs associated with these plants *will* be borne by someone — the only question is, by whom?[6]

Heeding overwhelming public policy considerations, both the ALJ and the Commission rejected Gulf States' untenable notion that the Commission should engage in regional protectionism by abrogating contracts on the basis of relative size and wealth of the litigants. The Commission cannot (and should not) be placed in the impossible position of deciding whether the customers in one region of the country are in a better position to pay (or absorb) costs than are customers who are located in another region of the country. As recognized by the ALJ and adopted by the Commission:

> The mere fact that Southern is larger does not establish that Southern would be any less damaged by the assumption of the capacity at issue than GSU would be, even if it were found that GSU was entitled to relief. In addition, it would not be desirable, as a matter of Commission policy, to favor one utility over another or to favor one region over another based upon the utilities' comparative sizes or a determination of relative need.

(Pet. App. at 89a, *adopted*, Pet. App. at 11a). The wisdom of this policy judgment, which is consistent with Commission precedent, is self-evident. *See, e.g., Western Massachusetts Electric Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,025, at 61,064 (1983); *Pennsylvania Power & Light Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,006, at 61,019, *reh'g denied*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,325 (1983).

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[6]Before the court of appeals and now, Gulf States has chosen to ignore the import of this question. More candid in this regard was its position before the ALJ and the Commission, where Gulf States flatly contended that Southern Companies were better able to "absorb" these costs for reasons including their relative sizes, financial conditions and local economic circumstances.

While conceding that the contracts are strictly cost-based, Gulf States doggedly insists that "non-cost factors" justify contract abrogation, and that the public interest would somehow be served thereby. The problem with this approach is Gulf States' totally self-serving view of the public interest, which in truth is neither company-specific to Gulf States nor regionally restricted to its service territory. As recognized in the initial decision:

> GSU's requested relief, which is tantamount to contract abrogation, and the theories upon which GSU rests its claim are fraught with negative public interest implications. Permitting contract abrogation in the circumstances herein would undermine the sanctity of contracts and in doing so, would create contractual instability in the electric utility industry. . . . Thus, even if the contracts herein did adversely impact the public interest, which they do not, the greater public interest in maintaining the stability and integrity of electric utility contracts would far outweigh GSU's perceived public interest.

(Pet. App. at 91a). *See NAACP v. Federal Power Commission*, 425 U.S. 662, 669-70 (1976).

Gulf States' plea that the Commission should have abrogated the contracts because its local retail regulators have disallowed pass-through of the resulting costs would, if accepted, render the Commission subservient to the "necessarily parochial concerns of the States." *Mississippi Industries*, 808 F.2d at 1549 (quoting *Middle South Services, Inc.*, 30 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 63,030, at 65,151 (1985)). Similarly, shifting the contract costs back to Southern Companies in order to ease financial difficulties that are directly attributable to inadequate retail rate treatment for Gulf States' River Bend Nuclear Plant would, in essence, cause the customers and stockholders of Southern Companies to subsidize the cost of that plant. FERC properly declined to abdicate its regulatory function in this manner, and instead evaluated the contracts under well-recognized standards governing section 206 of the Federal Power Act. With cost recovery as the starting point, the various "non-cost

factors" identified by Gulf States were separately evaluated in light of the evidence, precedent and public policy (including due regard for the interests of Southern Companies). When so tested, each such factor was found to be wanting.

B. Background and Nature of the Contracts

Until the early 1970s, Southern Companies (like other electric utilities in the United States) had experienced relatively stable and predictable load growth, and had made generation planning decisions in accordance therewith. Beginning in the early 1970s, however, Southern Companies began experiencing annual decreases in their load forecasts. It thus became necessary to adjust existing generation expansion plans by deferring or cancelling units that were no longer needed. By the late 1970s, the prospect of additional delays or cancellations was looming, even though such would result in additional costs at a later time.

In response to these conditions, Southern Companies began a concerted effort to sell capacity and energy to neighboring utilities. This initial effort only resulted in sales of long-term power (Schedule E) that produced insufficient revenues to support continuation of certain coal-fired generating units then under construction. In order to justify the tremendous investment needed to continue construction of those units, Southern Companies determined that unit power sales were required, and consequently focused their marketing strategy on the sale of unit power.[7]

In 1981, Southern Companies consummated UPS Agreements with Florida Power & Light Company ("FPL") and Jacksonville Electric Authority, but, despite this 1,400

[7]Schedule E capacity sales are generally priced on the basis of the embedded cost of the entire electric system, which (because it reflects the depreciated cost of both old and new units) is typically lower than the cost of constructing new generation. In contrast, the capacity pricing in a unit power sale is calculated to recover the full incremental cost of the dedicated unit.

megawatt ("MW") sale, faced serious problems justifying continued construction of various generating units on their existing schedules. Compounding this problem were the financial and retail regulatory difficulties being experienced by the two largest operating companies (Alabama Power Company and Georgia Power Company) associated with nuclear facilities that had just been completed (Farley Nuclear Plant) or were still under construction (Vogtle Nuclear Plant). It was at this time that Gulf States approached Southern Companies regarding the possibility of a long-term capacity purchase.

While Southern Companies were confronted with the prospect of having to delay or cancel generating units, Gulf States was facing a serious power supply deficit and substantial uncertainties regarding the cost and availability of its primary fuel source, natural gas. According to Gulf States, its major alternatives were to: (i) build additional generation; (ii) build new transmission facilities and import power; or (iii) leave its customers exposed to the uncertainties associated with using oil and natural gas as the primary fuel supply. While leaving its customers exposed to fuel supply uncertainties was not a viable alternative for Gulf States, neither did it favorably view the construction option because of its already strained financial and management resources associated with the ongoing construction of the River Bend Nuclear Plant. Gulf States was nevertheless considering the construction or lease of two 500 MW coal-fired units. The purchased power option was ultimately elected, and Southern Companies were determined to be the lowest cost suppliers.[8]

On February 25, 1982, Southern Companies and Gulf States executed the UPS Agreement pursuant to which Gulf States committed to buy and Southern Companies committed to sell 500 MW of unit power capacity over the period 1984 through May, 1992. On that same date, the parties also

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[8]The only other viable purchase option identified by Gulf States was unit power out of Middle South's Grand Gulf Nuclear Plant. If consummated, this purchase would have been far more costly to Gulf States than the purchase of coal-fired capacity from Southern Companies.

executed the Interchange Contract. The unit power sale to Gulf States, coupled with additional unit power sales to FPL[9] and a contemplated sale to Houston Lighting & Power Company ("HLP"), enabled Southern Companies to commit additional coal-fired generating units to the unit power sale program, thereby allowing the construction of those units to proceed on schedule.

Approximately one month after the execution of the UPS Agreement with Gulf States, HLP advised Southern Companies that it would be unable to make its contemplated 500 MW purchase of unit power capacity. On that very same day, Gulf States requested to purchase this additional unit power capacity. In accordance with Gulf States' request, the parties, on May 12, 1982, executed Amendment No. 1 to the UPS Agreement pursuant to which Gulf States increased the amount of unit power capacity it was purchasing from 500 MW to 1,000 MW.

As a consequence of the UPS Agreement with Southern Companies, Gulf States avoided investing time and money in a construction program for coal-fired units, and instead focused its financial and management resources on completing the River Bend Nuclear Plant. The burden of financing and building other capacity was contractually borne by Southern Companies. This corporate strategy on the part of Gulf States was announced in an address to its shareholders on May 13, 1982 — just one day after Amendment No. 1 to the UPS Agreement was signed.

In accordance with the requirements of the Federal Power Act and the Commission's rules and regulations, Southern Companies, on June 7, 1982, filed the UPS Agreement and the Interchange Contract with FERC. The Commission accepted the contracts for filing and instituted an investigation pursuant to section 206 of the Federal Power Act. *Southern Co. Services, Inc.*, 22 Fed. Energy Reg. Comm'n Rep.

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[9]As a consequence of the impending sale to Gulf States and pursuant to contractual rights contained in its UPS Agreement, FLP exercised an option to purchase additional unit power capacity from Southern Companies.

(CCH) ¶ 61,047 (1983). There were several intervenors in that proceeding, including Gulf States and the Louisiana Public Service Commission.

Under Section 1.1 of the UPS Agreement, Gulf States committed to "cooperate and assist Southern Companies in securing conclusion of the initial review by FERC of this Agreement without significant change hereto, in an expeditious manner." Notwithstanding that contractual commitment, however, Gulf States advised Southern Companies in a September, 1983 meeting that it would not be able to support the contract because of "changed circumstances." These circumstances included declining prices and increased availability of natural gas, anticipated difficulties with its retail commissions in Texas and Louisiana involving the soon-to-be-completed River Bend Nuclear Plant, the depressed economy in Gulf States' service territory and Gulf States' reduced load forecast indicating no further need for the capacity.

To address these concerns and to resolve the proceeding before the Commission, Southern Companies and Gulf States entered into a settlement agreement whereby capacity sales under the UPS Agreement were delayed and reduced to 0 MW, 400 MW, 500 MW and 600 MW for the years 1984, 1985, 1986 and 1987, respectively, and 700 MW for the years 1988 through May, 1992. Schedule E was added to the Interchange Contract, and Gulf States agreed to purchase lower cost long-term power thereunder in amounts corresponding to those deleted from the UPS Agreement. The parties also amended the UPS Agreement by adding Section 2.2.4 (providing that the amount of UPS capacity may increase, "but in no event decrease," due to changes in natural gas prices) and Section 2.2.5 (allowing Gulf States to relieve itself of the purchase obligation by finding an alternate purchaser). Southern Companies further agreed to a reduction in the return to be earned on common equity capital invested in the dedicated UPS units. The financial impact of these concessions, which are embodied in Amendment No. 2 to the UPS Agreement and Amendment No. 1 to the Interchange Contract, was a capacity-related

revenue loss to Southern Companies of approximately $350-400 million. The total adverse economic impact on Southern Companies was substantially greater if fuel-related costs are taken into account.

The above-described settlement agreement was filed with the Commission on December 8, 1983. By order issued March 23, 1984, the Commission approved that settlement, finding the contracts to be "just and reasonable and in the public interest." *Southern Co. Services, Inc.*, 26 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,360, at 61,796 (1984).

While the filing was pending before the Commission and thereafter, Southern Companies continued to construct the designated generating units from which capacity was contractually dedicated to Gulf States. Gulf States does not contend or even imply that Southern Companies have in any way failed to perform their contractual commitments with respect to the provision of capacity and energy under the UPS Agreement or Schedule E.[10] Indeed, Southern Companies' performance under the contracts has exceeded expectations, in that the actual cost of capacity and energy provided under the UPS Agreement and Schedule E has been lower than projected in 1981 and 1983. Further, Southern Companies in 1985 offered (and Gulf States accepted) Service Schedule R to the Interchange Contract, which enabled Gulf States to lower its energy costs under the UPS Agreement.

As the River Bend facility neared completion, retail regulatory pressure from the Texas and Louisiana commissions began to mount. By letter dated January 8, 1986, Gulf States requested that Southern Companies commence negotiations for consideration of "the elimination or suspension of capacity sales and purchases under the [UPS] agreement" pursuant to Section 2.2.1 thereof. That section provides:

> In the event either party desires to increase or decrease capacity sales or purchases for the years set

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[10]Although Gulf States raised a vague contention in its section 206 complaint regarding the availability of Schedule E, the contention was expressly abandoned during the evidentiary hearings.

> forth above, the parties agree to negotiate in good faith and with diligence to proceed to evaluate alternatives which may reasonably provide for such desired change in capacity; provided, that no such change shall be made except upon mutual written agreement of the parties hereto.

A series of meetings and telephone conferences subsequently took place, during the course of which Gulf States suggested modifying the contracts in a manner that was totally advantageous to Gulf States and totally detrimental to Southern Companies. Southern Companies' evaluation of these suggestions included a quantification of their adverse financial impact, which ranged from $250-600 million in lost capacity payments alone.[11] In response, Southern Companies offered several alternatives, specifically including a deferred payment proposal designed to address cash flow, which Gulf States had previously identified as its most pressing problem.

Gulf States abruptly terminated the negotiations by filing suit against Southern Companies in the United States District Court for the Eastern District of Texas (Beaumont Division). In conjunction therewith, it obtained permission from the district court, pursuant to rule 67 of the Federal Rules of Civil Procedure, to deposit into the registry the capacity and energy payments that were otherwise due Southern Companies under the contracts. Thereafter, Southern Companies, on August 25, 1986, petitioned the Commission for a declaratory order to terminate this controversy and to remove uncertainty concerning these FERC-approved contracts. Three days later, Gulf States filed its complaint under section 206 of the Federal Power Act.

C. Proceedings before the Commission

At the behest of Gulf States, consolidated proceedings involving Southern Companies' petition and Gulf States' complaint were conducted on an expedited basis before the

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[11]Gulf States' chief negotiator admitted that Gulf States never evaluated the financial loss to Southern Companies under any of its suggestions.

ALJ. During the course of over three weeks of evidentiary hearings, the parties compiled a record consisting of approximately 4,000 pages of transcript and hundreds of exhibits. With regard to its section 206 complaint, Gulf States conceded that the rates and charges under the contracts recovered only Southern Companies' cost of providing the service, but nevertheless argued that the contracts had been rendered unjust and unreasonable due to a variety of "non-cost factors." These factors, together with the findings and conclusions related to each, can generally be summarized as follows:

"Non-Cost Factor"	**Findings and Conclusions**
1. Unforeseen Changed Circumstances (natural gas prices and availability; lack of need).	— Identified and addressed by the parties in 1983 amendments. — Contractual risk was assumed by Gulf States. (Pet. App. at 73a-74a)
2. "Mismatched" Benefits and Burdens.	— Parties did not contemplate an entitlement to perpetual contractual benefits. — Gulf States received the bulk of its bargained-for benefits. — Southern Companies received no more than their cost of providing the service. — Gulf States' supporting benefits/burdens analysis was conceptually flawed, incomplete and inaccurate. (Pet. App. at 74a-82a).
3. Weakened Financial Condition.	— Principal cause is the need for retail rate relief associated with River Bend, not the contracts with Southern Companies.

"Non-Cost Factor"	Findings and Conclusions
	— Abrogating the contracts would not cure Gulf States' financial problems or assure its ability to provide reliable service. (Pet. App. at 82a-88a).
4. Retail Commissions' Refusal to Pass Through the Contract Costs.	— Parties did not intend performance under the contracts to be contingent on favorable retail rate treatment. — Southern Companies should not bear the cost of either imprudence by Gulf States or arbitrary actions by its state commissions. (Pet. App. at 102a-108a).
5. Southern Companies' Reliance on the Contracts to Build the Dedicated Units.	— Relevant question is not Southern Companies' reliance, but whether they have fulfilled their obligations, incurred costs in doing so and recovered no more than those costs through the contract rates. — Overwhelming evidence establishes Southern Companies' reliance on the contract revenues to continue unit construction. (Pet. App. at 114a-116a).
6. Southern Companies' Need for Capacity.	— Southern Companies' reserves are adequate. — Gulf States failed to prove any capacity need by Southern Companies. (Pet. App. at 116a-117a).

"Non-Cost Factor"	Findings and Conclusions
7. Southern Companies' Comparative Size.	— Relative size of litigants is not a legitimate consideration where contracts were freely negotiated at arms length by two commercial entities. — Favoring one utility or region over another based upon comparative size or relative need would be undesirable for policy reasons. (Pet. App. at 88a-89a).

On appeal to the Commission, these findings and determinations were affirmed in all material respects. (Pet. App. at 10a-23a). Responding to Gulf States' further contention that the contracts "promote inefficiency and waste of resources because [Gulf States] can generate energy more cheaply from its own resources," the Commission observed that the alleged inefficiency was not due to any aspect or provision of the contracts, but rather was the result of external circumstances (natural gas prices and diminished load growth) that could reverse themselves in the future. In any event, the Commission determined that, as a matter of public policy under the Federal Power Act, the goal of preserving and promoting contract stability far outweighed such possibly transient concerns. (Pet. App. at 23a-25a).

D. Southern Companies' Performance/Gulf States' Refusal to Pay

Despite its district court suit and its section 206 complaint against Southern Companies, Gulf States continued to utilize the capacity under the UPS Agreement by scheduling and taking energy under the contract.[12] Recognizing these to be

[12]As an engineering matter, energy will not flow over the tie lines connecting separate utilities so long as the system load and system generation of each are relatively balanced. Thus, Gulf States was not being

filed rates that are subject to the exclusive jurisdiction of the Commission, Southern Companies continued fully to perform their obligations under the contracts. Nevertheless, Gulf States did not comply with the capacity and energy payment provisions of the contracts, as evidenced by the following summary of events:

1. Since July, 1986, Gulf States has made no capacity payments to Southern Companies under the UPS Agreement and Schedule E, but (as previously noted) did obtain permission from the federal district court to deposit the capacity payments otherwise due Southern Companies into the registry of the court. Gulf States declined to pay Southern Companies, even though it was collecting these capacity costs from its retail ratepayers in Louisiana[13] and from its wholesale customers subject to FERC jurisdiction.

2. Beginning in July, 1986, Gulf States paid to Southern Companies only a portion of the energy charges under the contracts representing Gulf States' so-called "avoided cost," with the balance of the energy charges being paid into the registry. At all times, Gulf States was collecting from its retail and wholesale customers the full energy charges otherwise due Southern Companies under the contracts.

3. In October and November of 1986, the Texas and Louisiana commissions disallowed the collection from Gulf States' retail ratepayers of capacity charges under its con-

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forced to take this energy as a result of some unilateral act on the part of Southern Companies. Rather, its system operators would call their counterparts at Southern Companies to coordinate decreased generation by Gulf States and increased generation by Southern Companies. Through such coordinated action, energy would flow from Southern Companies to Gulf States for the latter's use.

[13]In May, 1986, Gulf States agreed to a rate reduction in Texas of approximately $80 million, of which approximately $55 million was attributed to the capacity costs associated with the contracts with Southern Companies. Gulf States apparently did so in order to obtain from the Texas commission an order establishing favorable accounting treatment pertaining to the River Bend Nuclear Plant. The disallowance of pass-through of the contract costs was only temporary, pending resolution of an ongoing case concerning Gulf States' prudence in entering into those contracts.

tracts with Southern Companies. The Texas commission so ruled on the grounds that Gulf States had been "imprudent" when it initially entered into the contracts, whereas the Louisiana commission, focusing on the prior action taken by the Texas commission, determined that continued collection from Louisiana ratepayers would contravene the "doctrines of Fundamental Fairness and Equal Protection." Since that time, Gulf States has neither paid Southern Companies nor deposited into the registry any capacity charges associated with its retail jurisdictions. Gulf States did continue to pay into the registry those capacity charges under the contracts associated with its wholesale business regulated by FERC.

4. Beginning in February, 1987, Gulf States ceased to deposit into the registry the wholesale portion of the capacity charges owed Southern Companies and the balance of the energy charges owed Southern Companies. Gulf States stopped doing so despite the fact that it continued to collect *all* energy charges from retail ratepayers in Louisiana and Texas, and all energy *and* capacity charges from its wholesale customers.

5. Even after February, 1987, Gulf States continued to schedule and utilize the capacity and energy under the UPS Agreement, while at the same time paying Southern Companies *nothing* for the capacity and paying only a portion of the invoiced energy charges (which portion is *less than* Southern Companies' actual cost of producing the energy). This intolerable situation persisted until the Commission issued its April 1, 1988, opinion upholding the validity of the contracts and its June 1, 1988, order denying rehearing. At this point, Southern Companies wrote Gulf States to demand payment of all past-due capacity and energy charges, together with adequate assurance of Gulf States' future performance. When Gulf States refused, Southern Companies were forced to petition the Commission for permission to suspend their performance under the contracts, which request was granted effective July 1, 1988. *Southern Co. Services, Inc.*, 44 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,290 (1988).

SUMMARY OF ARGUMENT

The petition for a writ of certiorari should be denied because the Commission quite properly refused to allow the exercise of its regulatory jurisdiction to be dictated by the actions of Gulf States' retail commissions in Texas and Louisiana. The evidence undeniably shows that Gulf States' weakened financial condition is not caused by the contracts at issue, but rather is the direct result of the refusal of those commissions to grant adequate retail rates to cover the tremendous costs associated with the River Bend Nuclear Plant. Contract abrogation under such circumstances would have been tantamount to extracting a subsidy from the customers and stockholders of Southern Companies to help defray the costs of River Bend.

FERC likewise correctly determined that the refusal of Gulf States' state commissions to allow the pass-through of the contract costs to its retail ratepayers on the grounds of alleged "imprudence" by Gulf States had no bearing on FERC's application of section 206 to these wholesale power contracts. If the state commissions are correct and Gulf States was imprudent, then contract abrogation would, in effect, shift the financial impact of that managerial imprudence to the customers and stockholders of Southern Companies. If the disallowance is unjustified, however, then abrogating the contracts would burden Southern Companies with the financial impact of irresponsible actions on the part of Gulf States' retail regulators. Either way, the result would be patently unfair to Southern Companies.

Instead of abdicating its regulatory authority in favor of Gulf States' retail commissions, FERC applied well-established principles under section 206 of the Federal Power Act. Beginning with the foundational cost-based inquiry, the Commission satisfied itself that Southern Companies were receiving no more than a recovery of the costs they incurred in performing their contractual obligations to Gulf States. Recognizing that non-cost factors may be considered in establishing a just and reasonable rate, the Commission then proceeded to evaluate each and every such factor cited by Gulf States. In the end, the factors were found to

present an inadequate basis upon which to abrogate these contracts as a matter of fact, law and/or public policy.

Stripped of its rhetoric and lofty discussions of economic theory, Gulf States' petition brings to this Court a rather commonplace contract dispute of the sort that lower courts handle on a routine basis. True enough, the dollars involved are substantial and the contracts are subject to regulatory approval but, in the final analysis, Gulf States is just another dissatisfied party to a contract seeking to escape a bargain that (at least in its view) is no longer sufficiently beneficial. Pertinent in this regard is the Court's prior admonition that section 206 of the Federal Power Act cannot be utilized to relieve a utility of an "improvident bargain" or to render a seller's contract unjust or unreasonable "simply because it is unprofitable to the public utility." *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956). Nevertheless, that is precisely what Gulf States sought to do in this case, and its request for contract abrogation was therefore denied. On appeal to the District of Columbia Circuit, that court affirmed the Commission a mere seven days following oral argument, commenting that "the petition does not warrant an opinion." (Pet. App. at 1a). Gulf States' petition to this Court is equally devoid of merit and should be denied.

REASONS WHY THE PETITION SHOULD BE DENIED

A. The Commission Correctly Declined to Abdicate Its Regulatory Responsibility in Favor of Gulf States' Retail State Commissions

1. *The Contracts Are Not the Cause of Gulf States' Financial Condition*

In its petition, Gulf States repeatedly references its weakened financial condition, thereby implying (but never quite saying) that the contracts with Southern Companies are the cause of that situation. Gulf States initially took that position; however, the evidence at the hearing clearly dem-

onstrated to the contrary.[14] As noted in the initial decision, the carrying costs and other costs associated with River Bend totalled approximately $900 million in 1987, an obligation that dwarfed the $132 million of capacity charges owed Southern Companies under the contracts. (Pet. App. at 84a-87a). In this regard, Southern Companies' evidentiary presentation showed that, if Gulf States were afforded reasonable retail rate relief associated with River Bend, then it could honor its contractual obligations to Southern Companies (even if the state commissions denied retail pass-through of the contract costs). Conversely, it was demonstrated that, absent adequate retail rate relief associated with River Bend, Gulf States could not survive, even if the contracts with Southern Companies were abrogated. In short, "[t]he evidence in the record overwhelmingly establishes that the principal cause of [Gulf States'] current financial difficulties is the failure of the state regulatory commissions to provide rate relief in connection with the River Bend Nuclear Plant . . . . " (Pet. App. at 87a, 18a-19a).

In conjunction with these determinations, the Commission specifically did not predicate its decision on any speculated level of retail rate relief. Rather, it refused, as a matter of public policy, to allow the exercise of its exclusive jurisdiction over wholesale arrangements to be "controlled by decisions made by state regulatory authorities exercising their proper authority over a utility's retail rates." (Pet. App. at 21a). Stated differently, FERC found untenable the notion that it should abrogate otherwise just and reasonable contracts in response to a financial condition that is directly traceable to

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[14]In its complaint, Gulf States contended that "the financial integrity of Gulf States is in jeopardy as a result of the Southern Companies agreements," and even went so far as to say that the possible denial of pass-through of the capacity charges was "[t]he greatest and most imminent threat to Gulf States' financial integrity." As the proceedings below progressed, Gulf States was forced by the evidence to downgrade this claim, ultimately asserting that the contracts are a "contributing factor" to its financial problems. In its petition to this Court, however, Gulf States has seemingly reverted to its original claim, representing that "Gulf States established that relief from the contract at issue is essential to its financial viability." (Pet. at 5).

the decisions of Gulf States' retail commissions. Moreover, had Gulf States addressed its anticipated capacity shortage by pursuing a "brick and mortar" construction program in 1982, rather than the purchase option from Southern Companies, it most assuredly could not have pursued the selective "abrogation" of its resulting financial obligations to vendors, contractors and investors. The Commission thus correctly declined to transform itself into the equivalent of a special bankruptcy court with only one creditor before it, namely Southern Companies.[15]

2. *The Contracts Are Not Rendered Unjust and Unreasonable by Virtue Of Unfavorable Retail Rate Treatment*

In its petition, Gulf States continues to argue (as it did to the Commission and to the court of appeals) that the disallowance of pass-through of the contract costs in retail rates by its Texas and Louisiana commissions should have led FERC to abrogate the contracts with Southern Companies. (Pet. at 9-10, 10 n.12, 19). Conspicuous by its absence is any supporting legal authority; indeed, governing Commission precedent is directly to the contrary. *See, e.g., Pennsylvania Power & Light Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,006, at 61,019, *reh'g denied*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,325, at 61,715-16 (1983).

In the initial decision, the ALJ recounted in detail the history of state regulation pertaining to these contracts, and in particular the ever-changing treatment such purchased power expense has received at the hands of Gulf States' retail regulators. The Texas commission previously characterized the contracts with Southern Companies as being "necessary to ensure adequate reserve margins and to help reduce dependence on oil and gas based energy," and later found that the contracts would provide significant savings for Gulf

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[15]Granting the relief requested by Gulf States would obviously not relieve Southern Companies of obligations they incurred in connection with the contractually-dedicated generating units. Rather, the financial burden of paying vendors, contractors and investors would simply fall on their customers or stockholders, as opposed to the customers and stockholders of Gulf States.

States' customers. For its part, the Louisiana commission intervened and participated in the 1983 proceedings before FERC, and consented to the settlement agreement that resulted in approval of the contracts.

Notwithstanding these actions, both state commissions subsequently disallowed retail pass-through of the contract costs, generally on grounds involving alleged "imprudence" on the part of Gulf States. Perhaps those commissions truly believe that Gulf States was imprudent, or perhaps they are engaging in sheer parochialism by attempting to direct costs from their constituents to the customers of Southern Companies. Either way, FERC correctly refused to allow its section 206 analysis to be driven by these actions. If the state commissions are correct and Gulf States was imprudent, then granting relief to Gulf States would impose on Southern Companies the adverse effects of Gulf States' poor management. This would be wrong; it should be for the Texas and Louisiana commissions to decide whether the public interest of their constituents is best served by keeping Gulf States financially viable, notwithstanding its managerial imprudence.

On the other hand, if Gulf States was indeed prudent in entering into these contracts, then the effect of FERC abrogating them in response to state commission action would be to shift to Southern Companies the financial impact of irresponsible regulation in Texas and Louisiana. An important economic safeguard would be negated, because the customers and stockholders of Southern Companies (and not those of Gulf States) would bear the brunt of opportunistic state commission decisions and political brinkmanship. For these and other sound policy reasons, the Commission independently examined the contracts under section 206, and did not allow the exercise of its regulatory jurisdiction to be "controlled by the necessarily parochial concerns of the States." *Mississippi Industries,* 808 F.2d at 1549. *See also Western Massachusetts Electric Co.,* 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,025, at 61,064 (1983).

B. The Commission Applied Well-Established Standards in Evaulating Gulf States' Complaint

Although Gulf States' petition strongly implies that the Commission's analysis of its complaint amounted to nothing more than a summary dismissal of its arguments and evidence as a matter of law, even a cursory scan of the underlying opinions of the ALJ and the Commission demonstrates to the contrary. In applying the just and reasonable standard under section 206, FERC began with the foundational inquiry of whether the rates and charges properly reflect the seller's cost of providing service, an interpretation that has been consistently applied since the very inception of the Federal Power Act. *See generally Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). *See also Pacific Power & Light Co.*, 27 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,080, at 61,148 (1984); *Pennsylvania Power & Light Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,006, at 61,019, *reh'g denied*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,325, at 61,716 (1983); *Ohio Edison Co.*, 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,344, at 61,749 (1983). Not only is the cost-based nature of section 206 a logical and practical basis for regulation, it is fundamentally consistent with this Court's pronouncements that the just and reasonable standard equates to constitutional standards ensuring a fair return and proscribing confiscation. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942).

While the Commission has a certain degree of latitude in determining what constitutes a just and reasonable rate, cost recovery and a fair return remain the touchstone. As explained in *Farmers Union Central Exchange, Inc. v. Federal Energy Regulatory Commission*, 734 F.2d 1486 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 (1984), the phrase "just and reasonable" translates into a "zone of reasonableness," with the upper end of the zone approaching "excessive" and the lower end of the zone approaching "less than compensatory." 734 F.2d at 1502. Although non-cost factors may impact the ratemaking process, the resultant rates must

nevertheless fall within the zone of reasonableness. *See, e.g., Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (if the public interest so requires, FERC may modify a contract containing a below-cost fixed rate and allow the seller to increase the rate to provide for a fair return); *Boroughs of Ellwood City v. Federal Energy Regulatory Commission*, 731 F.2d 959, 975 n.24 (D.C. Cir. 1984) ("[T]he Commission's power to remedy a price squeeze was limited by the lower end of the zone of reasonableness."); *Farmers Union Central Exchange, Inc. v. Federal Energy Regulatory Commission*, 734 F.2d at 1502-03 (non-cost factors do not allow the setting of rates above the zone of reasonableness). Such factors have never been applied in a manner that would deny the seller recovery of its prudently-incurred costs, which is the fate that Gulf States advocates for Southern Companies.

Apart from the fact that its legal position is contrary to overwhelming precedent, Gulf States is essentially urging this Court to engage in an academic exercise of statutory interpretation that, regardless of the outcome, would not change the result. This is because both the ALJ and the Commission engaged in a painstaking review of each and every non-cost factor identified by Gulf States, and determined that none of them provided any basis for contract abrogation. (Pet. App. at 73a-92a, 11a-25a). Under any legal standard, Gulf States' arguments fail as a matter of evidentiary fact.

C. Gulf States Seeks Review of a Routine Contract Dispute

Gulf States' petition brings to this Court a rather commonplace contract dispute of the sort that lower courts handle on a routine basis. Curious indeed is its protracted contention that FERC's decision creates some sort of "imbalance" between buyers and sellers in the bulk power market, as if the only way contractual risks can be avoided by a buyer is through after-the-fact regulatory intervention. (Pet. at 17-20). This is pure nonsense. The fundamental means of allocating risks like those identified by Gulf States is through

the negotiating and drafting process and through the related analysis leading to the management decision to enter into a contract. Thus, if Gulf States had expected absolute protection against unfavorable state retail rate treatment of the contract costs, it would have been a simple matter to require a "regulatory out" provision to achieve this end. Similarly, Gulf States could have chosen to negotiate a "market out" provision for the purpose of hedging against dramatic changes in the price of natural gas. Of course, Southern Companies would have had to agree to such risk-assigning provisions, and they likely would not have done so given the tremendous investment required for their performance. In any event, the assessment of such risks is an integral part of the analysis and bargaining process leading to a mutually-agreeable contract. When billion dollar commitments are at stake, the contractual allocation of risks simply cannot be subject to realignment through regulatory afterthought by one of the parties.

In the opinions below, both the ALJ and the Commission observed that the evidence and arguments of Gulf States ran afoul of numerous deeply-rooted policy considerations, perhaps the most prominent being the need to promote sanctity and stability of private contracts because they provide the foundational basis for wholesale power transactions. (Pet. App. at 24a) (citing *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 338, 344 (1956) and *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956)). In *Pennsylvania Power & Light Co.*, the Commission offered the following explanation of some of the reasons underlying that policy goal:

> [W]e note that power supply arrangements are often negotiated on a long-term basis. It requires many years to build a generating plant and the building utility must be able to rely on long-term sales contracts in making its own capacity plans just as the purchasing utility must be able to rely on long-term contracts for stability of supply. Demand forecasts may change dramatically and quickly, as we have seen in recent years. The prudence of a sales arrangement, therefore, should be judged on

> the circumstances prevailing at the time such a contract is entered into. If a State commission, this Commission, or a utility itself could release a party to a contract from its contractual commitments simply because the contract, based on hindsight and demand forecasts in later years, no longer appears economical, the utility industry would have no supply stability or reliable basis for constructing plant.

23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,006, at 61,019, *reh'g denied,* 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,325 (1983) (footnote omitted). *See also Western Massachusetts Electric Co.,* 23 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,025 (1983); *Philadelphia Electric Co.,* 15 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,264 (1981).

Despite Gulf States' attempts to argue that the Commission's decision would negatively affect the "ability of the industry to attract capital" and would result in the "skewing of buy-versus-build incentives," (Pet. at 25), the obvious fact is that no utility could enter into a power sale contract if, as Gulf States would have it, that contract is subject to "abrogation" whenever the other party (or its state regulator) deems a "mismatch" of benefits and burdens to have developed thereunder. Nowhere does Gulf States explain how "mutuality of benefit" is maintained under a remedy that would require the customers and stockholders of Southern Companies to bear the cost responsibility that Gulf States once freely assumed but now wishes to shirk. Why would potential sellers of wholesale bulk power ever agree to make the billion dollar investment necessary to their performance under such contracts? The answer, of course, is that they would not.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit should be denied.

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No. 89-1368

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OCTOBER TERM, 1989

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v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

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1. The Brief in Opposition of the Federal Energy Regulatory Commission makes no effort whatsoever to defend the correctness of the Commission's restrictive view of its jurisdiction over arms-length utility contracts, even though that view entails legal determinations of possible critical importance to the electric utility industry and to regulatory law. The Commission argues that this Court need not concern itself with the soundness of the Commission's new interpretation of its obligations under the Federal Power Act because the Commission purported to

decide certain factual aspects of the case (as an alternative to its holding that it had no jurisdictional duty to do so) in the favor of the other party to the contract here in question.

This circumstance, even assuming that it in fact occurred (*but see infra* ¶ 2), supports grant of *certiorari* and review of the Commission's erroneous and impermissibly narrow view of its own jurisdiction. It is virtually certain that the Commission will continue in future cases to deny its jurisdictional responsibilities in these areas, and its administrative law judges and the industry must perforce accept these pronouncements as the controlling law. *See, e.g., Public Serv. Co. of New Mexico*, 43 FERC (CCH) ¶ 61,469 (1988), *petition for review pending sub nom. San Diego Gas & Elec. Co. v. FERC*, No. 88-1744 (D.C. Cir. argued April 17, 1990). The Commission may also again make factual findings, purportedly obviating the need to decide the legal issues; in the Commission's view, such action would avoid judicial review and reversal of its indefensibly narrow construction of its statutory responsibilities.[1]

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[1] We are not suggesting here that the Commission's findings referred to in the Brief in Opposition were a conscious attempt to avoid future judicial scrutiny of its jurisdictional holdings, but rather that, in making those findings, the Commission was influenced and limited by its strong desire to avoid assuming jurisdiction over the lawfulness of arms-length utility contracts. *See* Pet. at 20 n.27. An agency adopting a limiting construction of a governing statute which, as our unrebutted petition shows, conflicts with its own precedent and judicial decisions, is under almost irresistible institutional pressure to avoid the subsequent issue by fact findings that in effect render its statutory holdings irrelevant. *See infra* ¶ 2. This Court has previously held that the resolution of fact disputes in similar circumstances is inherently suspect, and should not be a bar to a controlling statement by this Court of the extent of the agency's jurisdiction. *See Schwabacher v. United States*, 334 U.S. 182, 201-02 (1948).

This Court's primary responsibility, as it well knows, is to the correct development of federal law and construction of federal statutes, not the supervision of agency fact findings in particular cases, which are entitled to deference because of expertise and lack general importance. Where an agency makes a negative conclusion of law, and then alternative and inconsistent factual findings that arguably obviate the relevance of its negative statutory holdings, it can then apply the negative statutory conclusions as controlling precedent in later cases and effectively avoid this Court's and lower courts' review of its construction of its statute and regulatory responsibilities. *Cf. Honig v. Doe*, 484 U.S. 305, 318 (1988). We believe that any reasonable scrutiny of the record in this case will demonstrate that this is exactly what occurred before the lower court here.

2. One example will illustrate that the Commission's so-called fact findings were not an adequate attempt to resolve a factual issue under an alternative (and we would contend correct) interpretation of the statute. Gulf States argued that continuation of the enforcement of the contract in its present form would almost certainly drive it into bankruptcy. The Commission rejected this argument with the speculative, and factually unsupported, observation that it was possible that state commissions would provide relief from Gulf States' current regulatory problems stemming both from the contracts and the disallowance of the investment costs of Gulf States' River Bend nuclear plant. When Gulf States was able for the first time to present concrete and *unrebutted* evidence that the state commissions had not and most probably would not provide such relief, the Commission refused to reopen to consider the evidence. Pet. App. 33a, 35a. Since this evidence directly rebutted the Commission's earlier speculation that state commission relief would obviate Gulf States' insolvency threat, it is clear that the Commission did not make a bona fide effort to consider Gulf States' possible insolvency under the alter-

native construction of the Act that (contrary to its holding) it had that responsibility.

3. The Southern Companies ("Southern") present a lengthy opposition brief that misses the point. Southern manages never to mention the Commission's *legal determination* that an inefficient mismatch of benefits and burdens is not even "germane" under Section 206 of the Federal Power Act. It taxes Gulf States (Southern Opp. at 2 n.1) with asserting factual claims that the Commission rejected, but the point of the Petition is that Gulf States is entitled to factual determinations that flow from a proper understanding of the relevant legal principles. And if the issue is germaneness, Gulf States' factual assertions must be accepted as true.

Southern's entire argument is a defense of the *result* reached by the Commission. *Id.* at 19-26. But Gulf States is not asking this Court to determine whether the Commission reached the right result; and it is not, contrary to Southern's misunderstanding (Southern Opp. at 4), asking this Court to abrogate contractual obligations. Gulf States is asking for a remand so that the Commission can reach a result that is right because it is in accordance with the correct legal principles.

Southern further taxes Gulf States for not balancing Gulf States' interests with those of Southern's stockholders and customers. *Id.* Under the proper legal principles, the interests of the seller must of course weigh in the balance. Gulf States said so in its Petition (*see* Pet. at 20 n.26; 24 n.31), and such weighing is at the very core of a comparison of benefits and burdens. The Petition should be granted in this case precisely because the Commission cannot properly weigh all relevant interests when it views a mismatch of benefits and burdens as not legally "germane." Southern fails to address, let alone justify, that statutory interpretation by the Commission, which so narrows the Commission's responsibility for efficiency and fairness in interstate bulk power sales.

This Court should resolve the important statutory issues presented by this Petition, issues with respect to which the briefs in opposition do not even make a passing attempt to demonstrate the correctness of the Commission's view.

CONCLUSION

For these reasons as well as those set out in the Petition, a writ of *certiorari* should be granted.

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